Unofficial Translation

Tianrui Hotel Investment Co., Ltd. v. Hangzhou Yiju Hotel Management Co., Ltd.

Reply of the Supreme People's Court regarding the Request for Instruction on the Recognition of the Arbitral Award between the Applicant Tianrui Hotel Investment Co., Ltd. and the Defendant Hangzhou YiJu Hotel Management Co., Ltd.

(18 May 2010, [2010] Min Si Ta Zi No. 18)

Zhejiang High People's Court,

Your Court's Request for Instruction on the Recognition and Enforcement of a Foreign Arbitral Award between the Applicant, Tianrui Hotel Investment Co., Ltd., and the Respondent, Hangzhou YiJu Hotel Management Co., Ltd., No. [2010] Zhe Shangai Wai Ta Zi No. 3, has been received. After deliberation, we reply as follows:

The award concerned was made within British territory by the London Court of International Arbitration. As China and U.K. are both Contracting States to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter, the "**New York Convention**"), the award shall be reviewed in accordance with Art. 267 of Civil Procedure Law of the People's Republic of China and relevant provisions of the New York Convention.

Tianrui Hotel Investment Co., Ltd. and Hangzhou Yiju Hotel Management Co., Ltd. entered into a "Unit System Agreement" on 28 October 2004, which was a commercial franchise agreement. According to the regulations on the operation of commercial franchise then in force, a foreign company which intends to operate a commercial franchise within the Chinese territory should establish a foreign-invested enterprise and should obtain approvals from the competent administrative authority. However, the State Council's "Regulations on the Administration of Commercial Franchise", effective from 1 May 2007, only requires the parties to register the commercial franchise agreement with the administrative authority for record. An approval is not necessary. The registration requirement is a provision *jure gestionis*, which does not affect the effectiveness of the civil contract between the parties. The conclusions of the award concerning the "Unit System Agreement" do not violate the compulsory laws and public policy of our country. The requirements under Art. V(2)(b) of the New York Convention are not fulfilled in the present case. As to the disputes between SuBoAiTe (Beijing) International Hotel Management Co., Ltd. and Hangzhou Yiju Hotel Management Co., Ltd., they belong to a different legal relationship between different parties, whether the conclusion as to their disputes is consistent with the award of the present case is not a ground provided by Art. V of the New York Convention.

In conclusion, the award does not fall into any of the grounds under Art. V of the New York Convention. The People's Court should rule to recognize the award.

We reply as above.

Annex

Zhejiang High People's Court's Request for Instruction concerning the Request for Recognition of a Foreign Arbitral Award between the Applicant Tianrui Hotel Investment Co., Ltd. and the Defendant Hangzhou YiJu Hotel Management Co., Ltd.

(15 March 2010, [2010] Zhe Shang Wai Ta Zi No. 3)

The Supreme People's Court,

Hangzhou Intermediate People's Court received the request of the applicant, Tianrui Hotel Investment Co., Ltd. (hereinafter "**Tianrui Company**"), on the recognition of an award made by the London Court of International Arbitration against the respondent, Hangzhou YiJu Hotel Management Co., Ltd. (hereinafter "**Yiju Company**"). After review, the Court intended to reject the request of Tianrui Company and refuse recognition of the award. The Court reported to our court for instructions. After review, our court also holds that the award shall not be recognized. In accordance with the Notice of the Supreme People's Court on the People's Court Adjudication of Foreign and Foreign-related Matters concerning Arbitration, we hereby report the case as follows:

I. Information on the Parties and the Claims

Applicant: Tianrui Hotel Investment Co., Ltd., situated at Offsheore Chambers, P.O. Box 217, Apia, Samoa.

Counsel: Xia Dezhong, Yang Yong, Lawyer at Zhejiang Tiance Law Firm.

Respondent: Hangzhou YiJu Hotel Management Co., Ltd., situated at No. 5 WaiDongShanNong, Xihu District, Hangzhou City, Zhejiang Province, PRC China.

Legal representative: Zhu Hui, Chief Director.

Counsel: Cui Haiyan, Lawyer at Zhejiang Jindao Law Firm.

The applicant, Tianrui Company, submitted the following: on 28 October 2004, Tianrui Company and Yiju Company entered into the "Unit System Agreement" concerning the system of SUPER8HOTELS, according to which Tianrui Company granted permission to Yiju Company to use the trademark "SUPER8HOTELS" and other logos. The Agreement also set out specific requirements as to the standard according to which the Yiju Company was to operate the hotels and other details. After the Agreement was signed, Yiju Company acquired the trademark and the software to operate the Super 8 Hotels, but failed to pay the fees under the Agreement. According to the stipulation of the Agreement, Tianrui Company filed for arbitration with the London Court of International Arbitration on 21 November 2007. The LCIA issued the "final award" No. 7983 on 5 December 2008. According to Art. 267 of the Civil Procedure Law, Tianrui Company requested the enforcement of the award made by LCIA.

Yiju Company contended the following: (1) The recognition of the award would contradict the public policy of China. i. The Unit System Agreement was invalid due to violation of Chinese

law. Tianrui Company and its affiliated company, SuBoAiTe (Beijing) International Hotel Management Co., Ltd. (hereinafter "**SuBoAiTe**"), separated a franchise agreement into two agreements, namely the Unit System Agreement and the Unit Service Agreement, and signed with Yiju Company on the same day. This had the purpose of by-passing the Chinese regulations on the admission of foreign companies in the franchise business. The behavior of Tianrui Company apparently contradicted the fundamental system and legal provisions concerning the admission of foreign investment in China. ii. Tianrui Company and SuBoAiTe Company operated a franchise business against the law, which infringed the economic sovereignty of China, disturbed the economic order, and seriously contradicted the public policy of China. iii. Yiju Company already brought a lawsuit against SuBoAiTe Company, claiming the invalidity of the contract and the return of the relevant fees. The case was pending before the Hangzhou Intermediate People's Court. The tribunal was aware of the pending litigation when rendering the award which went against Chinese law. The award should not be recognized. (2) The arbitral proceedings were irregular. i. The arbitration clause under the Unit System Agreement only specified the arbitration rules as agreed by the parties but did not specify the arbitration institution and the place of arbitration. Such clause was invalid. ii. The arbitral proceedings did not conform to the law of the place of arbitration, as the tribunal did not have the power to consolidate three cases. Yiju Company therefore requested the court to reject the request of Tianrui Company.

II. Facts of the Case

The applicant Tianrui Company is a company registered under the law of Samoa Islands. On 20 October 2004, Tianrui Company and Yiju Company entered into a "Unit System Agreement" with the SUPER8HOTELS. The following was agreed under the Agreement: Tianrui Company granted permission to Yiju Company to use the trademark "SUPER8HOTELS" and other logos. Tianrui Company granted permission to Yiju Company to operate hotel services in several designated places. Tianrui Company agreed to provide Yiju Company with other services related to the operation of the hotels, in particular the service concerning the reservation system. Yiju agreed to pay for the abovementioned items, including consultancy fees, annual franchise fees, usage fees of the reservation system and other relevant fees. Yiju company also agreed to subscribe to appropriate insurance for the hotels. The Unit System Agreement also set forth detailed provisions concerning the standard of the hotels and the breach and termination of the Agreement. Art. 14.7 of the Unit System Agreement provides: "Any disputes, claims and contentions between the two parties to the Agreement arising out of or in relations with the Agreement shall be submitted to arbitration according to the Arbitration Rules of the London Court of International Arbitration. The Arbitration Rules constitute a part of the present Agreement. There should be one arbitrator." After the Agreement was signed, Yiju Company began operating the SUPER8HOTELS. The parties subsequently had disputes over the payment of the fees. On 18 September 2007, Tianrui Company sent a letter of termination to Yiju Company, terminating the Unit System Agreement.

On 21 October 2007, Tianrui Company filed an arbitration request to London Court of International Arbitration, demanding Yiju Company to pay the amount due, the default penalty, and the corresponding interest and fees. The LCIA appointed a sole arbitrator to arbitrate the case based on the written documents. Yiju Company participated in the arbitral proceedings from time to time, and objected to the tribunal's jurisdiction and the validity of the arbitration

clause. The LCIA issued the Final Award No. 7983 on 5 December 2008, holding the following: (1) The tribunal is competent to hear the case; (2) The Unit System Agreement does not contravene Chinese law and is not invalid; (3) Yiju company breached the contract and Tianrui Company had the right to terminate the Agreement. Yiju Company should pay Tianrui Company in a total amount of 828,505.8 RMB plus the legal fees $53,657.55 dollars. Yiju Company should also bear the relevant arbitration fees.

The court also found the following: on the same date Tianrui Company and Yiju Company signed the Unit System Agreement, the two parties concluded an Agreement on the Use of the Reservation System as an annex to the Unit System Agreement. Yiju Company and SuBoAiTe (Beijing) International Hotel Management Co., Ltd. (a company registered in China which is affiliated to Tianrui Company, hereinafter SuBoAiTe Company) signed a Unit Service Agreement. The three agreements constitute a chain of interrelated agreements. After Tianrui Company submitted the disputes to arbitration, Yiju Company brought a lawsuit against SuBoAiTe Company and Tianrui Company as co-defendants to the Hangzhou Intermediate People's Court on 29 November 2007, which became the case No. [2007] Hang Min San Chu Zi No. 413 on the disputes over the franchise agreement. Since Tianrui company raised objection to the jurisdiction of the court, after the appeal before our court, our court has rejected the claims of Yiju Company against Tianrui company on the ground that there was an arbitration agreement under the Unit System Agreement between Yiju Company and Tianrui Company. In addition, in another case between Hangzhou Heju Hanting Hotel Co., Ltd. and SuBoAiTe Company concerning the disputes over the franchise agreement, which resembles the present case, the court of first instance held that the Unit System Agreement was indivisible from the Unit Service Agreement and the franchise agreement concerned was invalid. The court ordered SuBoAiTe Company to return the corresponding amount, and SuBoAiTe Company brought an appeal before our court. The appeal is under adjudication.

III. Opinion of the Hangzhou Intermediate People's Court

Hangzhou Intermediate People's Court held as follows: (1) The Unit System Agreement concluded between Tianrui Company and Yiju Company is a franchise agreement. Franchise operation is a domain with limited access in China. Art. 3 of the Administrative Measures on the Foreign Investment in the Domain of Business provides: "Foreign-invested business enterprises are enterprises which carry out the following activities […] iv. Franchise: By way of contract and in the purpose of obtaining benefits and franchise fees, one grants another to use its trademark, trade name, and business pattern, etc. Foreign companies, enterprises and other economic entities or individuals must carry out the abovementioned activities i, ii, iii, and iv via a foreign-invested enterprise within the Chinese territory." Art. 33 of the Administrative Measures on the Commercial Franchise requires that if foreign-invested enterprises intend to carry out business activities through franchise, they should seek the approval from the original authority in charge of approval to include "carry out business activities through franchise" in the scope of business. On the Guiding Catalogues for Foreign Investment, franchise operation is a constrained industry subject to state control. As a company registered and existing under the law of Samoa Islands, Tianrui Company is not entitled to directly carry out franchise activities pursuant to relevant administrative regulations. According to Art. 10 of the Supreme People's Court Interpretation No. 1 on the Implementation of Contract Law of the People's Republic of China, "if parties exceed the scope of business and sign a contract, the People's Court should not hold the contract

to be invalid, except for circumstances where laws and regulations concerning the constrained business, franchise business, and other business are violated." Consequently, Tianrui Company and Yiju Company violated the mandatory provisions of Chinese law by concluding the Unit System Agreement to carry out franchise business. The purpose of the laws and regulations concerning the franchise agreement is to set strict limits for foreign investment and to maintain the economic and social order of our country. Tianrui Company's behavior violated the fundamental system on the admission of foreign investment and contravened the public policy of our country. Therefore, according to Art. V(2)(b) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter, the "**1958 New York Convention**"), the award should not be recognized. (2) Though only the Unit System Agreement between Tianrui Company and Yiju Company was subject to arbitration before the LCIA, Yiju Company brought before the court a lawsuit based on the Unit Service Agreement between Yiju Company and SuBoAiTe Company, which was closely related to the Unit System Agreement. Tianrui Company and SuBoAiTe Company intentionally separated one agreement into two in order to by-pass Chinese regulations on the admission of foreign companies in the domain of franchise business. If the award is recognized, while the court rules in favor of Yiju Company, the two decisions will conflict with each other.

In conclusion, in accordance with Art. 140(1)(9) and Art. 269 of Civil Procedure Law, the Hangzhou Intermediate People's Court intended to decide to refuse the recognition of the award No. 7983 made by the LCIA on 5 December 2008.

IV. Opinion of Our Court

Our court believes that as the award was made in London, U.K., and the U.K. is a Contracting State to the 1958 New York Convention, the Convention is applicable to the recognition and enforcement of the award. According to the 1958 New York Convention, the court where enforcement is sought is competent to review whether circumstances of non-recognition under Art. V(1) and Art. V(2) of the Convention are fulfilled by the award.

The parties disputed two issues: (1) whether the arbitration agreement is valid and whether the procedure is legal; and (2) whether the award contravenes the public policy of China.

As to whether the arbitration agreement is valid and the arbitral proceedings legal: the Unit System Agreement provides: "Any disputes, claims and contentions between the two parties to the Agreement arising out of or in relations with the Agreement shall be submitted to arbitration according to the Arbitration Rules of the London Court of International Arbitration. The Arbitration Rules constitute a part of the present Agreement. There should be one arbitrator." According to Art. 16.1 of the Arbitration Rules, chosen by the parties, namely the LCIA Arbitration Rules, "The parties may agree in writing the seat (or legal place) of their arbitration. Failing such a choice, the seat of arbitration shall be London, unless and until the LCIA Court determines in view of all the circumstances, and after having given the parties an opportunity to make written comment, that another seat is more appropriate." The place of arbitration, according the Arbitration Rules, can be fixed as London. Since parties did not agree on the law applicable to the validity of the arbitration clause, the law of the place of arbitration, i.e., English law, should be the law applicable to the validity of the arbitration clause. According to English Arbitration Act 1996 and the LCIA Arbitration Rules, the arbitration agreement is valid. With

regard to the arbitral proceedings, Yiju Company failed to prove that the tribunal was not entitled to consolidate the three cases. The proceedings are therefore legal.

As to whether the award violates the public policy of China: admittedly, violation of mandatory laws does not necessarily constitute violation of social public interest of China. However, in the present case, SuBoAiTe Company and the affiliated Tianrui Company intentionally separated the franchise agreement into two agreements in an attempt to by-pass the Chinese regulations on the admission of foreign companies in the franchise business. This can be considered a violation of the social public interest of China.

In light of the above, our court holds that the award No. 7983 made by the LCIA violates the public policy of China, and pursuant to Art. V(2)(b) of the 1958 New York Convention, the award should not be recognized.

In accordance with Art. 2 of the Notice of the Supreme People's Court on the People's Court Adjudication of Foreign and Foreign-related Matters concerning Arbitration, we hereby report the case to your court for instructions.