



Franchise

in 33 jurisdictions worldwide

2013

Contributing editor: Philip F Zeidman



Published by
Getting the Deal Through
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Franchise 2013

Published by
Law Business Research Ltd
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Tel: +44 20 7908 1188
Fax: +44 20 7229 6910
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ISSN 1752-3338

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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Korea

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Overview

1 What forms of business entities are relevant to the typical franchisor?

The stock company and the limited liability company are the business forms in South Korea that would be relevant to the typical franchisor. About 90 per cent of Korean companies are stock companies, which are similar to US stock companies. Only this legal entity, plus occasionally the limited liability company, is recommended for foreign investors and businesses.

2 What laws and agencies govern the formation of business entities?

Primarily, the Korean Civil Act and Korean Commercial Code govern the formation of business entities. In addition, the Foreign Investment Promotion Act relates to the formation of business entities from foreign investment.

The Korean Court Commercial Registrar, National Tax Service and Ministry of Knowledge Economy are the main agencies that have authority relating to the formation of business entities.

3 Provide an overview of the requirements for forming and maintaining a business entity.

There is no minimum paid-in capital for a stock company or a limited liability company. Registration is with the Court Commercial Registrar and National Tax Service. In the case of foreign business entities' or foreigners' investment, they must report to the Ministry of Knowledge and Economy (in practice, the function of receiving reports is delegated to designated foreign exchange banks or the Korea Trade Investment Promotion Agency).

4 What restrictions apply to foreign business entities and foreign investment?

A foreigner may freely carry on foreign investment activities in Korea without being subject to any restrictions unless otherwise specifically restricted by the Foreign Investment Promotion Act or other laws and regulations. Specifically, a foreigner is not to be restricted from foreign investment other than in the following cases:

- where it interferes with the safety of the nation or maintenance of public order;
- where it causes harm to the health and safety of nationals or is markedly contrary to public morals and decency; or
- where it violates Korean laws and regulations.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

The principal taxes affecting business enterprises in Korea include corporate tax, individual income tax, value added tax, customs

duties, and inhabitant tax levied on corporate tax, income tax and other taxes.

The franchisor has a duty to pay taxes (corporate tax or individual income tax) on royalty incomes. However, the tax rates are limited to the rate stipulated in the tax treaty between Korea and the state in which the franchisor resides. In this regard, the franchisee has a duty to withhold such taxes from the royalties it pays to the franchisor.

6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

Under the Korean Civil Code, an employer is liable for a tort committed against a third party by an employee who is under the employer's actual direction or supervision, in relation to the performance of a work that is directed or supervised by the employer. Therefore, if a franchisee or a franchisee's employee is deemed an employee of the franchisor, the franchisor may be held liable for damages to a third party caused by the franchisee or the franchisee's employee during the performance of his or her work.

To reduce the risk of such liability, it is advisable for the franchisor not to be involved with the specifics of the franchisee's management and to specify in the franchise agreement that the franchise will be operated by the franchisee as an entity independent from the franchisor. However, since a franchisor and a franchisee are generally independent entities and, therefore, the franchisee is not subject to the direction or supervision of the franchisor, we think that the above liability will rarely occur.

7 How are trademarks and know-how protected?

Korea is a 'first-to-file' jurisdiction. To obtain reliable protection of trademark rights in Korea, the owner of the trademark should register it with the Korean Intellectual Property Office pursuant to the Trademark Act. During the application period, no protection is provided. However, while the application is pending, the applicant may send a warning letter to a person who uses an identical or similar mark on goods that are identical or similar to the goods for which the application has been filed. If the trademark application subsequently becomes registered, the applicant (now the registrant) may bring a claim against such person for losses accrued from the date the written warning was received by such person up to the registration date of the trademark.

Once the registration is granted, the owner may seek to enforce the trademark rights against third-party infringements by seeking injunctive relief against further infringement or damages (or both), or by an order for the destruction of infringing goods.

In addition to the Trademark Act, the Unfair Competition Prevention and Trade Secret Protection Act is available to protect well-known unregistered trademarks, trade secrets and know-how.

- 8 What are the relevant aspects of the real estate market and real estate law?

Ownership of Korean real estate by foreigners was previously regulated in two ways: restrictions on title to land under the Alien Land Acquisition Act, and restrictions against leasing real estate (land or building) under the Foreign Investment and Foreign Capital Inducement Act. However, the Alien Land Acquisition Act was substantially amended, effective 25 June 1998, permitting a foreigner to purchase real property located in Korea with a simple report of the acquisition of title to the relevant local government office. In addition, through amendments to the Foreign Investment and Foreign Capital Inducement Act on 1 April and 1 July 1998, foreign investment in the business of leasing real estate was fully liberalised (the name of this Act was changed to the Foreign Investment Promotion Act from 17 November 1998).

Laws and agencies that regulate the offer and sale of franchises

- 9 What is the legal definition of a franchise?

Under the Fairness in Franchise Transactions in Franchise Business Act (Franchise Act), a 'franchise' is defined as:

[...] a continuous business relationship in which the franchisor allows the franchisee to sell goods (including raw and auxiliary materials) or services under certain quality standards and business method using its trademarks, service marks, trade name, signs and other business marks (collectively, 'Business Marks'), and supports, educates and controls the franchisee with regard to relevant management and operating activities, and in which the franchisee pays franchise fees to the franchisor in return for the use of the Business Marks and the support and education concerning the management and operating activities.

- 10 Which laws and government agencies regulate the offer and sale of franchises?

The Franchise Act that was enacted on 1 November 2002 and most recently amended on 17 February 2012, and its Presidential Decree, are the primary statutes applicable to the franchisor-franchisee relationship. Additionally, the Monopoly Regulation and Fair Trade Act (MRFTA) and regulations promulgated by the Korea Fair Trade Commission (KFTC) and the Korean Commercial Code are generally applicable to the relationship.

The KFTC regulates franchises in Korea. The KFTC has a franchise-related department and has the authority to impose administrative measures against those who engage in unfair activities. In this regard, the KFTC has the discretion to determine the unfairness or reasonableness of the activities of the franchisor and to levy penalties and issue corrective orders against those violators depending on the unfair nature of the activity. However, the violator may seek a district court's judicial review of the KFTC's findings.

- 11 Describe the relevant requirements of these laws and agencies.

The Franchise Act is based on the principle of good faith and fair dealing and tries to provide a framework for building a fair and equal business relationship between the parties involved in franchising. The Franchise Act delegates the task of overseeing the franchise industry to the KFTC, and the KFTC in turn provides necessary guidance and order by monitoring the industry through corrective measures and penalties for those who violate the Franchise Act.

The Franchise Act is divided into six main chapters. Chapter I sets the stage by providing the purpose of the Act and the definitions of various terms used throughout the Act. Chapter II deals with the basic principles that govern the franchise transactions, and chapter III has to do with fairness in franchise transactions, which, among other

requirements, places a disclosure requirement on the franchisor. Chapter III also provides a list of basic provisions that need to be included in a franchise agreement. Chapter IV provides for a nine-member dispute mediation committee regulated by the KFTC and details the qualifications and the roles of the committee. Chapter IV also defines the roles and responsibilities of a 'franchise consultant'.

Chapter V deals with the disposition of cases under the KFTC and contains details of the corrective measures that can be instituted, including a provision on an administrative fine imposed on a franchisor that violates certain provisions of the Franchise Act. Furthermore, because this chapter also makes references to provisions of the MRFTA, a franchisor must also be concerned with the application of the MRFTA. Chapter VI imposes administrative and criminal liabilities on the people who violate the Act, and depending on the type and degree of violation, the person may be subject to a maximum prison sentence of up to five years or a penalty of not more than 150 million won.

- 12 What are the exemptions and exclusions from any franchise laws and regulations?

Article 3 of the Franchise Act provides that the Act will not be applicable, for example, to the delivery of a disclosure document to a prospective franchisee, if the total franchise fee paid by the franchisee to the franchisor for a six-month period beginning from the date of initial payment of the franchise fee does not exceed an amount of 1 million won or if the franchisor's annual sales amount is less than 50 million won. The 1 million won and 50 million won are prescribed by the Presidential Decree of the Franchise Act.

- 13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

Although the disclosure requirement under the Franchise Act requires a franchisor to disclose information if the franchisor operated or is operating a franchise, there is no law or regulation that mandates that the requirements must be satisfied before a franchisor may offer franchises.

- 14 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

A master franchisor need not provide a disclosure document to a sub-franchisee if the master franchisor is not in a contractual relationship with the sub-franchisee; that is, a master franchisor has no obligation to provide a disclosure document if it is not a party to the franchise or any other agreements with a sub-franchisee.

Disclosure documents must contain a description of the general status of the franchisor (see question 16 for a list of information to be disclosed). Although neither the Franchise Act nor its Presidential Decree specifically requires that the information concerning the master franchisor and the contractual or other relationship between the master franchisor and the sub-franchisor be included in the disclosure documents, as the information relates to the 'description of general status of the franchisor', it would be appropriate to include a rough summary of such information.

- 15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

Under the old Franchise Act (prior to the 2007 revision), franchisors were excused from the obligation to make disclosure to prospective

franchisees unless the prospective franchisee had specifically requested delivery of the disclosure document in writing.

However, under the current Franchise Act:

- a franchisor must provide a disclosure document to the prospective franchisee even if the franchisee does not specifically request it in writing;
- in providing the disclosure document to a prospective franchisee, the franchisor must register the disclosure document with the KFTC first and then provide the registered disclosure document to the prospective franchisee; and
- acceptance of a franchise fee or execution of a franchise agreement is prohibited unless the franchisor provides the registered disclosure document and 14 days have elapsed from the date of provision of the registered disclosure document.

The disclosure document may be furnished to a prospective franchisee by:

- providing the disclosure document (hard copy) directly or sending it by mail to the prospective franchisee;
- providing the disclosure document in an electronic file on a disc (or other similar medium that may be recorded, kept and printed from);
- providing the disclosure document via access to the internet; or
- sending the disclosure document in a soft file to the prospective franchisee's e-mail address.

With regard to the update of the disclosures, a franchisor must register (or report) any changes in the disclosure documents with the KFTC. Depending on the importance of the information that has been changed, deadlines for filing the report thereto range from 'within 30 days from the occurrence of the cause of the change' and 'within 30 days from the expiration of the quarter in which the cause of the change has occurred' to 'within 120 days from the expiration of each fiscal year'.

16 What information must the disclosure document contain?

The following broad categories of information are required to be contained in the disclosure document:

- information regarding the general status of the franchisor;
- information regarding the current status of the franchisor's franchise;
- information regarding any legal violation by the franchisor and its executive;
- information regarding the obligations of the franchisee;
- information regarding conditions of and restrictions on business activities;
- information regarding detailed procedures and the period required in respect of the commencement of franchise business; and
- information regarding education and training programmes (it must be specified if there is no plan for education and training).

17 Is there any obligation for continuing disclosure?

According to the Franchise Act, if disclosures have been made in accordance with the Franchise Act, under article 5-3(1) of the Enforcement Decree, franchisors are required to prepare and register (or report) with the KFTC an amendment to the disclosure document within:

- 30 days from the date the changes occurred (if the changes pertain to the general status of the franchisor);
- 30 days from the end of the quarter in which the change occurred (if the changes pertain to obligations of the franchisee, or conditions of and restrictions on business activities); or

- 120 days from the end of the fiscal year in which the change occurred (if the changes pertain to the current status of the franchisor's franchise).

18 How do the relevant government agencies enforce the disclosure requirements?

Where franchisors have violated their duties to provide a disclosure document or have provided false or exaggerated information, the KFTC may require the franchisor to provide or amend the disclosure document; report on necessary plans or actions taken or any other measures necessary for correction of such violations (corrective measures); or it may arrange a plan for correction and recommend that a franchisor follow such a plan (recommendation of corrective measure). With respect to such violations, the KFTC may impose an administrative fine of an amount not exceeding 2 per cent of the franchisor's total sales.

Furthermore, in the event that a franchisor violates certain provisions of the Franchise Act relating to disclosure requirements (for example, where a franchise fee has been accepted or a franchising agreement has been executed before providing the disclosure document, or where a franchisor has provided false or exaggerated information or omitted important information), the KFTC may file a criminal complaint with the attorney general. It is worth noting that a complaint from the KFTC is required for a public criminal action to be instituted for violation of the Franchise Act.

19 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

See question 17 for legal remedies and assessing damages for violating the disclosure requirements.

In the case of violation of disclosure requirements, the franchisee may report such violation to the KFTC. Furthermore, the franchisee may bring a lawsuit for damages and cancel or rescind the franchise contract under general principles of tort or contract law in accordance with the Korean Civil Code. If there remain damages that are not recovered by cancelling and rescinding the contract, the franchisee may additionally be entitled to such damages, apart from such cancellation or rescission.

Violations of the Franchise Act may be introduced in a lawsuit for damages as evidence of a party's pattern of conduct or culpability for conduct but, in general, such violations do not have any bearing on the calculation of damages in a civil context. Damages are calculated by the general principles of tort and contract law (proximate causation theory) and there is no specific law and regulation applied to the franchise transaction.

In connection with the criminal penalties, the Franchise Act does not create any private rights of action. The franchisee can only report the franchisor's violations to the KFTC. A complaint from the KFTC is required to institute a public criminal proceeding against violators of the Franchise Act. If receiving a report from the franchisee or investigating on its own initiative, the KFTC may decide to institute a public criminal proceeding depending upon the 'seriousness' and 'clarity' of the violation of the franchisor. In addition, the attorney general may, on its own initiative, request the KFTC to file a complaint, and in such a case, the KFTC must comply with the request. Once a public criminal indictment has commenced the KFTC cannot withdraw the complaint.

In theory, the criminal penalties under the Franchise Act for disclosure violations are among the most severe in the sphere of Korean business.

The harshest penalty is reserved for fraud; provision of false or exaggerated information or omission of important items from disclosures required under the Franchise Act carries a penalty of up to five years' imprisonment or a fine of not more than 150 million won under article 41, paragraph 1 of the Franchise Act. Failure to provide a disclosure document, or execution of a franchise agreement or acceptance of a franchise fee within the 14 days prior to the provision of the disclosure document, is subject to a possible term of imprisonment of up to two years or a fine of up to 50 million won under article 41, paragraph 3 of the Franchise Act.

Refusal to comply with the KFTC's orders to provide disclosure, if such orders are given, is also potentially subject to a serious penalty. Where disclosure is not provided, or where the disclosure is later reviewed by the KFTC upon the franchisee's request and found to be incorrect (but not fraudulent), the agency may demand that the franchisor provide proper disclosure materials. Failure to do so in the face of the KFTC's 'corrective order' may be subject to up to three years' imprisonment or a fine of up to 100 million won under article 41, paragraph 2 of the Franchise Act.

In addition, in certain cases of disclosure failures, the KFTC may order the return of the franchise fee.

The KFTC generally prefers to apply pressure to a party – usually the franchisor, given the objective of the statute – to correct its behaviour in order to avoid the application of criminal sanctions.

- 20** In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

A master franchisor has no duty to provide a disclosure document if it is not a party to the franchise or any other agreements with a sub-franchisee. In such a case, liability for disclosure violations is solely attributable to the sub-franchisor.

If individual officers, directors and employees of the franchisor engage in a disclosure violation, they are exposed to liabilities similar to those of the franchisor. They may be subject to damage claims filed by the franchisee or criminal penalties.

- 21** In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

The general fair trade principles under the MRFTA may affect the offer and sale of franchises (see question 10). No other regulation, government agency or industry code, besides the KFTC, may affect the offer and sale of franchises.

- 22** Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

No.

- 23** What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

Fraudulent or deceptive practices by a franchisor may constitute fraud as stipulated by the Korean Criminal Code. In the case of a disclosure violation, the franchisee can only report such violation to the KFTC

who will then determine whether to file a criminal proceeding. In the case of fraudulent or deceptive practices constituting criminal fraud, a franchisee may directly file a criminal complaint with the public prosecutor. In addition, a franchisee may file a lawsuit for damages against the franchisor with or without cancelling or rescinding the franchise contract.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship

- 24** Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Franchise Act regulates the ongoing relationship between the franchisor and franchisee after the franchise contract comes into effect.

- 25** Do other laws affect the franchise relationship?

General fair trade principles under the MRFTA may affect the offer and sale of franchises (see question 10).

- 26** Do other government or trade association policies affect the franchise relationship?

The guidelines provided by the KFTC may affect the franchise relationship.

- 27** In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The Franchise Act does not specify grounds for termination of the franchise agreement; it merely provides the procedure to be observed when terminating the franchise relationship.

Under the previous Franchise Act, when a first notice of breach from the franchisor (which stated the grounds of breach and a request to cure such breach, and stated that failure to cure would result in termination of the agreement) was received by the franchisee, the two-month cure period 'clock' began to run (and the franchisee's obligation to cure arose at this point). During this cure period, the franchisor could send two additional notices of the same breach, which worked as a reminder for the cure. If the franchisee failed to 'cure' the breach during this period, the relationship could be terminated.

Under the new Franchise Act, the notice provision works in the same way, except that the new Franchise Act only requires one additional notice rather than two. In addition, the new revision expanded the exceptions to the notice and cure requirement (that is, specific reasons by which the franchise agreement may be terminated without notice or the opportunity to cure) to include the following:

- bankruptcy or composition is filed against the franchisee or a corporate reorganisation and compulsory enforcement procedures are commenced;
- a promissory note or cheque issued by the franchisee is not duly paid due to insolvency, etc;
- a franchisee is no longer able to manage the franchise business due to force majeure or significant personal reasons, etc;
- a franchisee's public dissemination of false facts considerably damages the franchisor's reputation or credit, or the franchisee leaks trade secrets or important information regarding the franchisor that brings about a significant impediment to the franchise business;

- where the franchisee violates laws or regulations in relation to the operation of the franchise business and receives a notice of administrative action ordering correction (including imposition of administrative fines), but the franchisee fails to correct it within the time specified (10 days from receipt of notice if no deadline is specified);
- where the franchisee violates laws or regulations in relation to the operation of the franchise business and receives an administrative action that, by its nature, cannot be corrected, including revocation of qualification, licence or approval or an order suspending business (except orders ordering suspension of business for less than 15 days);
- where the franchisee, after complying with the franchisor's demand for correction of breach pursuant to article 14, paragraph 1 of the Franchise Act, repeats the same violation within one year (in cases of renewal of the franchise agreement, the relevant period in the initial term is accumulated with the renewed term) from the date of the correction, provided that the foregoing does not apply where the franchisor, in its written demand for correction, fails to state the fact that the franchise agreement may be terminated without going through the procedure under article 14, paragraph 1) of the Franchise Act if the franchisee repeats the same violation within one year (from the date of the correction);
- a franchisee has been subjected to criminal punishment for an act related to the operation of a franchise shop;
- a franchisee operates a franchise shop in a manner that arouses concern for imminent danger to public health and safety; or
- a franchisee stops operation for seven consecutive days without justifiable reason.

28 In what circumstances may a franchisee terminate a franchise relationship?

Under the Franchise Act, no restriction or prior notice is required for franchisees to terminate their relationship. As a general principle of law, however, the franchisee may terminate the franchise agreement in the case of default by the franchisor. In addition, where the franchise agreement is seen as a 'continuing contract', the franchisee may also terminate the agreement based on the grounds that the purpose of the agreement has been frustrated as a result of unforeseeable circumstances.

29 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Under the old Franchise Act, there were no restrictions imposed on the franchisor's right to refuse to renew the franchise agreement.

However, the new revision of the Franchise Act prescribes that if the franchisee requests a renewal between 180 days and 90 days prior to the expiration of the franchise agreement, the franchisor may not refuse to renew the franchise agreement without just cause. As exceptions, the franchisor is permitted to refuse to renew the franchise agreement in the following circumstances:

- the franchisee has failed to perform its payment obligations of the franchise fee under the franchise agreement;
- the franchisee has not accepted the terms and conditions of the franchise agreement or business policy that are generally accepted by other franchisees; or
- the franchisee has failed to observe the following important business policies of the franchisor that are deemed necessary for maintaining the franchise business:
 - matters pertaining to the procurement of a store or facility that is necessary for the operation of a franchise, or acquisition of licence, permit or approval as required by law;

- matters pertaining to observance of production methods or service methods that are necessary for maintenance of quality of goods or services for sale; and
- other matters that are deemed necessary for normal operation of the franchise as determined by Presidential Decree.

If the franchisee requests a renewal, the notice of refusal stating the reasons for the non-renewal must be provided within 15 days of receipt of the request for the renewal. If the notice of refusal (to the franchisee's request for a renewal) is not provided to the franchisee, or a written notice of non-renewal or change in terms and conditions (for the renewal) is not provided to the franchisee between 180 days and 90 days prior to the expiration of the franchise agreement, the franchise agreement will be deemed to have been renewed under the same terms and conditions therein.

As a cautionary note, even if the franchisee does not request a renewal, a franchisor must provide a written notice of non-renewal of the franchisee (between 180 days and 90 days prior to the expiration of the franchise agreement) if the franchisor has no intent or does not wish to renew the franchise agreement. If the franchisor first provided a notice of non-renewal (prior to the franchisee's request for renewal) within the above period, then the franchisee subsequently requests a renewal within the same period (despite the franchisor's notice of non-renewal), the franchisor may not refuse to renew the franchise agreement without just cause. In other words, the franchisor's notice of non-renewal (before the franchisee has made a request for renewal) would realistically work only as a reminder to the franchisee to decide whether to renew the franchise agreement or not.

The franchisee's right to request a renewal may only be exercised for a total duration of 10 years (including the term of the original franchise agreement), and if 10 years have lapsed, the franchisor may refuse to renew the franchise agreement regardless of its reasons (as long as a written notice of non-renewal has been provided).

30 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Because it can be said that the franchisor-franchisee relationship is reciprocal, where both parties are creditors as well as debtors to each other (supply obligation on the one hand and payment obligation on the other hand), we are of the opinion that the franchisee should receive the consent of the franchisor prior to the transfer of the franchise business (transfer of its obligation) to a third party. In this regard, the Franchise Act, under article 6, paragraph 9, provides that the franchisee has to first obtain the prior written consent of the franchisor to assign the franchise business. Thus, a franchisor may restrict a franchisee's ability to transfer its franchise.

However, unless the parties have specifically agreed not to allow the transfer of ownership interests in a franchisee, there is no restriction on the franchisee's right to transfer ownership interests.

31 Are there laws or regulations affecting the nature, amount or payment of fees?

The Franchise Act stipulates that 'the franchise fee', regardless of what it is called or what form it comes in, shall mean the amount that comes under the following:

- consideration that the franchisee pays to the franchisor in consideration for franchise management rights, such as the permission to use business marks or support and education for its operating activities, such as application fee, membership fee, franchise fee, education and training fee or down payment, etc;
- consideration that the franchisee pays to the franchisor to secure payment for goods supplied by the franchisor or compensation for damages;

- (iii) consideration that the franchisee pays to the franchisor for fixtures, equipment or goods supplied by the franchisor for the purposes of commencing the franchise at the time of the granting of franchise management rights;
- (iv) consideration, specified in the Presidential Decree, that the franchisee pays to the franchisor on a regular or irregular basis in consideration for the support and education related to the use of business marks approved under its agreement with the franchisor, operating activities and other matters; or
- (v) all other considerations that the prospective franchisee or franchisee pays to the franchisor for purposes of acquiring or maintaining franchise management rights.

In connection with the franchise fees under the above items (i) and (ii), the new revision of the Franchise Act has implemented a system whereby the franchise fees may be deposited (for example, in an escrow account) with a certain financial institution instead of making a direct payment to the franchisor, and the franchisor is allowed to withdraw the franchise fee once the franchisee officially begins its operation of the franchise shop or after two months have elapsed from the date of execution of the franchise agreement. Here, the financial institution must be an institution in Korea as defined in the Presidential Decree.

In lieu of depositing the franchise fees with a financial institution, the franchisor may subscribe to an insurance policy (with the franchisee as the beneficiary) to cover the franchisee's risks. Once the franchisor subscribes to a policy, the franchisor is free to collect the franchise fees at any time.

With regard to the franchise fees deposit requirement in particular, it is difficult to find a financial institution that will open an escrow account for the benefit of a foreign franchisor. Therefore, for foreign franchisors, the only practical option is to subscribe to an insurance policy in lieu thereof.

Finding an insurance provider that offers a policy that is specifically focused for franchise fees purposes is also difficult. We have not yet seen any overseas insurance provider that offers such policy (this is probably because the insurance subscription requirement is unique to Korean franchise law). Even in Korea, most insurance providers do not offer such policy.

For purposes of illustration, a policy offered by an insurance provider in Korea is a policy created specifically for the purposes of franchise transactions and looks like this:

- the insurance premium is a flat rate of 0.667 per cent of the initial (upfront) franchise fee;
- for foreign franchisors who have no business presence in Korea there is an 'extra premium' of 60 per cent of the initial premium; and
- the period of coverage is for two months (which is in line with the two-months rule noted above).

Therefore, if the initial franchise fee is US\$150,000:

- the premium would be US\$1,000.50 (0.667 per cent of US\$150,000: and
- the extra premium would be US\$600.30 (60 per cent of US\$1,000.50).

Hence, the total amount that the franchisor would need to pay to subscribe is about US\$1,600.80.

32 Are there restrictions on the amount of interest that can be charged on overdue payments?

There are no specific restrictions on the amount of interest that can be charged on overdue payments. However, if the interest is deemed excessive, it can be void for violating public policy.

33 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

There are no such laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency.

34 Are confidentiality covenants in franchise agreements enforceable?

In principle, confidentiality covenants in franchise agreements are enforceable.

35 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Apart from the specific rules applicable to a franchisor's conduct, the Franchise Act also promulgates a 'code of best practice'. Under article 4 of the Franchise Act, both parties to a franchise relationship must exercise good faith in the performance of each of their respective duties in connection with the management and operation of the franchise.

The franchisor's duties are defined in article 5 of the Franchise Act as follows:

- business planning for the success of the franchise;
- continuing efforts toward quality control of goods or services and development of sales techniques;
- installation of shop facilities and supply of goods or services to the franchisee at reasonable prices;
- education and training of the franchisee and its employees;
- continuing advice and support for the management and operating activities of the franchisee;
- prohibition against establishing a franchisor's directly managed shop or establishing a franchise business in a similar line of business to that of the franchisee within its business area during the period of the franchise agreement; and
- making efforts to resolve disputes through dialogue and negotiations with the franchisee.

The franchisee's duties are defined under article 6 of the Franchise Act as follows:

- making efforts to maintain the unity of the franchise and the good reputation of the franchisor;
- maintenance of inventory and display of goods in an appropriate manner in accordance with the franchisor's supply plan and consumer demand;
- compliance with appropriate quality standards as presented by the franchisor with regard to goods or services;
- use of goods and services as provided by the franchisor in the event of failure to stock goods or services that meet the quality standards provided in the preceding point;
- compliance with appropriate standards as presented by the franchisor with regard to the facilities and exterior of the place of business, as well as the means of transport;
- consultation with the franchisor prior to effecting any changes in the goods or services in which it deals or in its operating activities;
- maintenance and provision of the data necessary for unified business management and sales strategy formulation by the franchisor, including, but not limited to, accounting books on the purchase and sale of goods and services;
- provision to the officers, employees or agents of the franchisor of access to its place of business for the checking and recording of its business status and the data as set out in the preceding point;
- prohibition of any change in the location of its place of business or any transfer of franchise management rights without the consent of the franchisor;

- prohibition of any act engaging in the same line of business as that of the franchisor during the period of the franchise agreement;
- prohibition of disclosure of sales techniques or trade secrets belonging to the franchisor; and
- notification of any infringement of business marks by a third party to the franchisor if it becomes aware of such infringement, and appropriate cooperation with the franchisor to take necessary measures to prohibit such infringement.

The Franchise Act provides neither criminal penalties nor sanctions for a party's failure to adhere to the standards established. Therefore, we interpret most of these provisions as normative or best practice standards, rather than mandatory rules. Consequences will result only if a party violates the provisions incorporated into the terms of a contract.

36 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

In principle, franchisees are deemed to be independent commercial entities; therefore, there are no laws that specifically treat franchisees as consumers for the purposes of consumer protection.

37 Must disclosure documents and franchise agreements be in the language of your country?

Under the Franchise Act, there is no requirement that the disclosure documents be prepared in the Korean language. However, because the Franchise Act prescribes that the disclosure document (that will be provided to the prospective franchisee) must be registered with the KFTC (see question 15), the KFTC may, on practical grounds, require the disclosure documents to be prepared in the Korean language for registration.

The Franchise Act does not prescribe that the franchise agreement be written in the Korean language, either. However, it is advisable for foreign franchisors to critically evaluate the English-language capabilities of any prospective Korean franchisees and be prepared to offer a Korean translation of the franchise agreement if the franchisee does not comprehend English or is not using consultants who are competent to assist with any language deficiency. In addition, when filing an application for registration of the disclosure document with the KFTC, a copy of the franchise agreement must be submitted, and if the franchise agreement is in another language, a Korean translation must also be submitted. Therefore, it is necessary to prepare a Korean translation of the franchise agreement for the purposes of registration of the disclosure document as well.

38 What restrictions are there on provisions in franchise contracts?

Article 12 of the Franchise Act places certain restrictions on the franchisor's behaviour, which are adapted from principles articulated in the MRFTA. Specifically, a franchisor may not, whether directly or through another enterprise, commit any act that falls under any of the following and which may obstruct fair trade in the franchise business:

- refusal to transact (except in cases where the franchisee breaches the terms of the franchise agreement or is liable for acts of wrongdoing which prevent the continuation of a franchise business relationship):
 - refusal to provide business support (for example, suspension or refusal of the provision of real estate, services, equipment, products, materials and components necessary for the operation of the franchise business);
 - unjust termination of contract; or
 - unjust refusal to renew contract;
- transactions with restrictive terms:
- restriction of prices (for example, activities that improperly require the franchisee to maintain prices of products sold by the franchisee that are determined by the franchisor) (except in cases where the franchisor only encourages the franchisee to sell the product at a price determined by the franchisor, or in cases where pre-negotiation or prior agreement are allowed in determining or changing the sales price);
- restriction of a transaction counterparty (for example, that which improperly require the franchisee to transact with a particular transaction counterparty (including the franchisor) in relation to the acquisition or lease of real estate, services, equipment, products, materials and components required for the franchise business) (except in cases where (i) acquisition or lease of real estate, services, equipment, products, materials or components is objectively recognised as critical in management of the franchise business, (ii) when dealings are not done with a particular counterparty, the protection of the franchisor's trademark and preservation of the uniformity of the products or the services is objectively recognised as difficult, and (iii) the franchisor notifies the franchisee of such restriction through the offering circular and enters into an agreement with the franchisee);
- restriction on the sale of products or services (such restrictions would include activities that improperly require the franchisee to sell only particular products or services)(except in cases where (i) protection of the franchisor's trademark and preservation of the uniformity of the products or services is objectively difficult without such restriction, and (ii) the franchisor notifies the franchisor of such restriction through the offering circular and enters into an agreement with the franchisee);
- coercion of observance of business territory (except in cases where (i) the franchisor determines the base of the franchise business, (ii) the franchisor allows for the operation of the franchisee to conduct business beyond the business territory upon sufficient sales being reached first within the business territory, and (iii) the franchisee who wishes to operate beyond his or her business territory is required to pay compensation for the promotion and advertising of the existing franchisee in that business territory);
- activities similar to the cases described in the first, second, third and fourth sub-bullets above, which improperly restrict the business activities of the franchisee(except in cases where the franchisor does not have any restrictions on the operation of the franchise business, it is objectively recognised that the protection of the franchise trademark and the uniformity in its products and services are difficult to maintain, and that the franchisor notifies the franchisee of such facts through the offering circular and enters into an agreement with the franchisee);
- abuse of bargaining power (except in cases where the occurrence of the any of the following acts is not restricted, it must be objectively recognised that the protection of the franchise trademark and the uniformity in its products and services are difficult to maintain, and that the franchisor notifies the franchisee of such facts through the offering circular and enters into an agreement with the franchisee):
 - mandatory purchase (activities that require the franchisee to purchase or lease facilities, equipment, products, services, materials, components, etc, in excess of the volume necessary to engage in the franchise business);

Update and trends

In recent years, there has been a tremendous increase in the demand for franchise rights among non-corporate individuals. As competition among those who obtained franchise rights has become fierce, the over-exertion of bargaining power by franchisors and consequential disputes also seem to be on the rise. What seems particularly troublesome is franchisors' disrespect to territorial rights and coercing remodelling as a condition for renewal rights.

These problems are more apparent in the 'Bakery War', where a number of local conglomerates are fiercely competing for the largest market share. Blinded by the will to drive competing brands out, the franchisors aggressively launched their own stores, sometimes even in the vicinity of their franchised stores, causing the franchise store owners to suffer the most.

To protect the territorial rights of the franchise store owners, the Fair Trade Commission established the Model Franchise Transaction Standards for bakeries in April 2012.

The key points of the Model Transaction Standards include rules which:

- prohibit bakery franchisors from opening a new store within 500 metres of a franchised store if the franchisor:
 - owns more than 1,000 stores; or
 - owns 100 or more stores and annual sales exceed 1 trillion Korean won; and
- mandate bakery franchisors to provide support for 20 to 40 per cent of remodelling costs if remodelling is a condition precedent to the franchisee's renewal rights.

The Fair Trade Commission plans to closely monitor the disclosure documents and franchise agreements and provide 'guidance' to ensure compliance with the Model Franchise Transaction Standards (for bakeries). Recently, the Fair Trade Commission expanded these standards to pizza and chicken delivery franchises.

The Model Standards, technically, do not have any legal enforceability. Therefore, how the Fair Trade Commission will 'guide' the franchisors to comply with such standards in the near future is worth monitoring.

- making unreasonable demands (eg, demanding that the franchisee provides economic profits or takes the burden of expenses);
- improper establishment or amendment of contract provisions (establishing or amending contract provisions that make it difficult for the franchisee to perform or that are disadvantageous to the franchisee or, in relation to the renewal of the franchise agreement, amending or establishing contractual terms that are clearly disadvantageous compared to the previous terms and conditions of the contract or terms and conditions of the contract with other franchisees);
- interference with management (including acts that require the operation of a franchise with a particular person without proper cause); or
- mandatory sales targets (unjustly establishing sales targets and forcing franchisees to meet such targets);
- infringement of business territory:
 - establishing its own or its subsidiary's shop or franchise shop for the same business as the franchisee within the business territory of the franchisee during the term of the franchise agreement in breach thereof (however, the foregoing does not apply if the fact that the franchisor is not granting an exclusive business territory licence to the franchisee was notified to the franchisee in the disclosure document and the franchise agreement entered into also specifies that no exclusive licence is granted).

- other unfair trade practices:
 - activities which cause loss to the franchisee or other competing franchisors by including the franchisee of another competing franchisor to transact with the franchisor.

39 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

The Franchise Act was originally drafted to adapt the provisions of the MRFTA into the franchise context. Therefore, the Franchise Act is the general law that is applicable to franchises (the MRFTA would not generally apply to franchises since the Franchise Act is more specific to the franchise context).

40 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Korean legal system is a civil law system, originally adopting the European civil law system and Japanese legal system. The Korean judiciary system is three-tiered and consists of the Supreme Court (the highest court), the high courts (the intermediate appellate courts) and the district courts (the courts of first instance). There are five high courts and 18 district courts, divided into geographical districts.

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Alternatively, the parties in dispute may resolve disputes relating to the franchise agreement via mediation or arbitration. In particular, the Franchise Act provides that a franchise transaction dispute mediation committee may mediate matters related to disputes over franchise transactions if requested by the KFTC or by the parties in dispute. The franchisor is free to reject a mediation request. However, if mediation is requested due to an alleged violation of the MRFTA or the Franchise Act, it is advisable for the franchisor to comply with the request, because upon refusal, the franchisor may find itself subject to corrective measures under the Franchise Act.

The Korean Commercial Arbitration Board (KCAB) is the only authorised institution of arbitration in Korea. The KCAB is dedicated to the settlement of commercial disputes as a neutral, unbiased and independent institution for administering and conducting arbitration, conciliation and mediation. Arbitration before the KCAB is an alternative way of producing impartial and fair resolutions to commercial disputes.

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- 41** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

Unlike litigation before the courts of jurisdiction, arbitration awards are not appealable and, therefore, may resolve a dispute through a single proceeding. In addition, because arbitration procedures are not public, important information regarding the franchise transaction may be kept confidential.

However, there is no means to challenge an arbitral award, even if it is considered unjust. In addition, arbitration proceedings may take longer than adjudication before the court of first instance (in many cases, the dispute practically comes to an end when the judgment of the court of first instance has been given), meaning the dispute may be unnecessarily prolonged.

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- 42** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Aside from minor differences in connection with the obligation to report real estate acquisitions (see question 8) and the restrictions imposed by the Foreign Investment Promotion Act (see question 4), foreign franchisors are not treated differently from domestic franchisors.



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