



International Distribution Institute

在中国特许经营实务

Franchising in China

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尽职调查 – Due Diligence

- Trademark Search in the PRC Trademark Database – apply for mark used in the home jurisdiction
- Identity of PRC prospect – in Chinese characters only – search for 营业执照 – business license – check for litigation history?
- Hong Kong side trips – not recommended
- Do you comply with the “2+1 Rule”?



尽职调查 – Due Diligence

- Is your system a 特许经营 (franchise) under PRC law?
- Will the franchise activities take place in the PRC
- Definition:
 1. Grant of rights to use business operating resources;
 2. Requiring the franchisee to use a uniform mode of operation;
 3. Franchisee pays franchise fees under the agreement



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进入中国市场的方式 – Method of Entry

Options:

- Master Franchise Agreement
- Area Development Agreement
- Area Representative Agreement
- Unit Franchise Agreement
- Joint Venture Agreement

Initially large franchisors used joint ventures and corporate stores or unit franchise agreements

Later they preferred to take more direct control

Smaller entrants now use mostly master franchise agreements



知识产权保护 – IPR Protection

- Register trademarks in as many classes as your budget will allow
- Collect assignments of copyright even from employees
- Consider copyright registration particularly if online enforcement is anticipated
- Consider Design Patent applications to protect trade dress



知识产权保护 – IPR Protection

- 商业秘密 (trade secrets and confidential information) are not easy to protect unless you are familiar with the evidentiary hurdles in PRC courts
- The courts give more weight to documentary evidence from third parties, and notarized documents are used to prove a buy of counterfeit goods
- Necessary to keep detailed records of what information is disclosed to which persons, and of the methods used to maintain confidentiality

协议草案 – Term Sheet

- Territory – all of China? – better to use provinces – what is “China”? Taiwan? Hong Kong SAR? Macau SAR?
- Chinese Trademark – ask the prospect to create a mark for your approval and registration
- Deposit – need an agreement – usually combined with an LOI – enforceability?

协议草案 – Term Sheet

- The 合同法 (Contract Law) is based on the German *Bürgerliches Gesetzbuch*
- Article 42 contains the doctrine of “*culpa in contrahendo*,” and thus negotiations must be conducted in good faith
- Accordingly the provisions of a non-binding term sheet may create obligations
- Should include binding provisions on IP and confidentiality, etc.



特许经营合同 – Franchise Agreement

- Recommend that it be bilingual – paragraph by paragraph, because:
 1. A Chinese language version will be required for registration with the Ministry of Commerce (MOFCOM)
 2. Most of the people working for your PRC franchisee may have difficulty reading English, and if they can read it, there is a better chance of compliance
 3. If there is a dispute, the PRC franchisee will have difficulty saying that they did not understand the agreement
 4. If disputes are to be settled in a PRC court, the judge will require an agreed upon translation.



特许经营合同 – Franchise Agreement

- Key issues in enforcement:
 - Very difficult, usually impossible to enforce your home court's decisions in the PRC
 - PRC courts are fast and relatively inexpensive
 - Arbitration is slower and more expensive, in part because the arbitral award must be recognized by a Chinese court
 - In franchise cases, the monetary amounts are usually not high, but the IPRs are very important



特许经营合同 – Franchise Agreement

Other Significant Issues:

- Non-compete clauses with individuals are limited by the 劳动合同法 (Labour Contract Law) and the need to make post term payments
- When approving translations, need to collect assignments of copyright from the translator.
- Who in the franchisor will review and approve advertising and marketing programs?



特许经营合同 – Franchise Agreement

Other Significant Issues:

- E-commerce authorizations
- In the event of default, will the franchisor try to take over the local system? To hold a lease, the franchisor would need a PRC legal entity, such as a WFOE.



特许经营披露文件 - FDD

- Required by Articles 20 to 23 of the 中华人民共和国商业特许经营管理条例 (PRC Commercial Franchise Administration Regulation) from the State Council and the 商业特许经营信息披露管理办法 (Commercial Franchise Information Disclosure Administrative Measures) from the Ministry of Commerce
- PRC courts now focus on disclosure when assessing the validity of a franchise agreement, rather compliance with the 2+1 Rule or registration with MOFCOM
- If the franchisor otherwise has a mature business model, but discloses non-compliance with the 2+1 Rule and lack of a registration, the agreement will be held valid



特许经营披露文件 - FDD

Article 22(8) of the Regulations requires the disclosure of the number and location of the existing franchise outlets in China, their distribution by region, and an assessment of their business performance.

In 2012 the Measures were amended to add:

2、现有被特许人的经营状况，包括被特许人实际的投资额、平均销售量、成本、毛利、纯利等信息，同时应当说明上述信息的来源。

2. Information regarding the operations of the franchisees, including the actual amount of investment, average gross sales, costs, gross profits and net profits, and describe the source of the above information.



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特许经营披露文件 - FDD

Article 23 of the Regulations requires that the information provided shall be:

真实、准确、完整

true, accurate and complete

And the franchisor must not conceal information or give false information



商务部备案 – MOFCOM Registration

- Article 8 of the Regulations requires recordal of the franchise system 15 days after the first franchise agreement is signed
- In practice the foreign applications are seldom made that quickly
- The aspect of the application causing the most difficulties is evidencing compliance with the 2+1 Rule as expressed in the second paragraph of Article 7 of the Regulations.
- Articles 24 and 25 set out fines for not being in compliance with the 2+1 Rule and for not registering. We are not aware of foreign applicants being fined.



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商务部备案 – MOFCOM Registration

Compliance with the 2+1 Rule:

- Franchisor must evidence that it has operated 2 locations for not less than 1 year as of the date of the first sale
- Can be anywhere in the world
- Problems are what MOFCOM accepts as evidence of such operation, and the fact that franchisors usually hold such locations through affiliates.
- The definition of “affiliate” in corporate law varies



商务部备案 – MOFCOM Registration

Compliance with the 2+1 Rule:

- If the franchise agreement is still valid if you do not register with MOFCOM, why register?
 - Being register will greatly assist your master franchisee in attracting further investment etc.
 - It will help in getting money out of the country
 - It is still required by law



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有问题吗？ - Questions?





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