FRANCHISING IN THE ASIA-PACIFIC REGION

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1. INTRODUCTION

There is little doubt that the future of franchising lies in the developing economies of the Asian region, where population growth and economic development will drive high levels of demand for goods and services over the next decades. Franchising in the Asia Pacific region is already beginning to experience the exponential growth seen in the United States in the 1980’s and 1990’s, and in Australia form 1990 until mid 2000.

Asia has always been recognized for its potential, as it is the most populous region in the world. However, the ascension of several Asian countries to the World Trade Organization after they have implemented structural reforms and established an effective regime for the protection of intellectual property gives the Asian region a more realistic appeal. As a collateral benefit, the Australian dollar has appreciated significantly against the US dollar and is relatively strong amongst the Asian currencies, lessening the establishment and support costs for Australian franchise systems. Governments in the Asian region are seen as largely pro-franchising, with countries such as Singapore and Malaysia having specific programs aimed at encouraging franchising. Specific regulatory frameworks have been established in many Asian countries to give franchising credibility, as franchising is seen as an excellent mechanism to educate, train and empower local people.

In this paper we examine the regulatory environments for the major countries in Asia - China, Hong Kong, India, Indonesia, Japan, Kazakhstan, Macau, Malaysia, New Zealand, Singapore, South Korea, Taiwan, Thailand, and Vietnam. Although the regulatory frameworks differ significantly, the Australian market remains probably the most comprehensively regulated market in the region, and possibly the world. Elements of the Australian model have been adopted in several countries, most notably Vietnam and Malaysia. We give detailed focus to China and India, the two most populous markets in the region.

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Parts of this paper have been drawn from previous articles and publications written by Stephen Giles including in particular material submitted to a paper by Stephen Giles, Andrew Loewinger and Sherin Shakir entitled Go East Young Franchisor – Franchising in Asia Pacific Excluding China and India, to be presented to the American Bar Association Forum on Franchising in October 2011, and from the various country chapters in International Franchise Sales Laws, American Bar Association, Editors M Lindsey and A Loewinger, Asian Editor S. Giles. Further sources include Getting the Deal Through - Franchise in 32 jurisdictions worldwide 2011 published by Law Business Research Ltd and M Abel et al, ‘Franchising in the BRIC Markets’, American Bar Association 31st Annual Forum on Franchising 2008. These documents contain detailed analysis of the various regulatory regimes and are recommended further reading for those seeking more detailed coverage.
Franchising is flourishing throughout the Asian region irrespective of the regulatory environment. The following statistics sourced mainly from the World Franchise Council² illustrate the strong penetration of franchising in the region, and the potential for further growth and development. Economic expansion, globalization and urbanization have created a demand for different goods and services and helped feed the development of franchising. Consumers have become much more brand conscious, and although in most countries the majority of franchising systems remain home grown³ a significant number of US and Australian systems have successfully established operations in the region. There is an obvious opportunity for Australian franchise systems as they can establish an early foothold in markets predicted to continue to expand and develop over the next century.

<table>
<thead>
<tr>
<th>Country</th>
<th>Franchise systems</th>
<th>Sector turnover</th>
<th>Number of units</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia (2011)</td>
<td>1,100</td>
<td>$184.3 Billion</td>
<td>92,300</td>
<td>775,000</td>
</tr>
<tr>
<td>China</td>
<td>4,000</td>
<td>$US 29.6 Billion</td>
<td>330,000</td>
<td>2,400,000</td>
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<tr>
<td>Hong Kong</td>
<td>92</td>
<td>N/A</td>
<td>3,000</td>
<td>N/A</td>
</tr>
<tr>
<td>India</td>
<td>850</td>
<td>$US 3.8 Billion</td>
<td>48,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1475</td>
<td>$US 5 Billion</td>
<td>42,900</td>
<td>820,000</td>
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<tr>
<td>Japan (2010,2004)</td>
<td>1,206</td>
<td>$US 257 Billion</td>
<td>231,666</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>300</td>
<td>$US 1 Billion</td>
<td>2,000</td>
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</tr>
<tr>
<td>Malaysia (2009)</td>
<td>408</td>
<td>N/A</td>
<td>500,000</td>
<td>N/A</td>
</tr>
<tr>
<td>New Zealand (2010)</td>
<td>423</td>
<td>nz$29 Billion</td>
<td>23,600</td>
<td>80,400</td>
</tr>
<tr>
<td>Philippines</td>
<td>1000</td>
<td>P$ 150 Billion</td>
<td>108,000</td>
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</tr>
<tr>
<td>Singapore (2009)</td>
<td>420</td>
<td>$US 3.8 Billion</td>
<td>30,000</td>
<td>N/A</td>
</tr>
</tbody>
</table>

² Figures for Macau are not available. All figures should be treated as approximates. Other sources including the internet have been used where the WFC information did not exists or was incomplete. As the table is intended only to be indicative, no further verification was undertaken.

³ For example in Australia over 90% of franchise systems are home grown, according to the Franchising Australia Survey 2010. According to the Philippines Franchise Association the figure is 64% in the Philippines, whilst in Indonesia the figure is 75% according to the Indonesian Franchise Association.
Country | Franchise systems | Sector turnover | Number of units | Employment |
--- | --- | --- | --- | --- |
South Korea (2008) | 2,400 | $US 70 Billion | 260,000 | 1,000,000 |
Taiwan (2005) | 300 | $US 46 Billion | 10,000 | N/A |
Thailand (2008) | 400 | $US 2.5 Billion | 30,000 | N/A |
Vietnam (2010, 2008) | 70 | $US 36 Million | 890 | N/A |

2. DIFFERENT MODELS FOR FRANCHISE REGULATION

There are a variety of models for franchise regulation in Asia. The regulatory environment runs the gamut from no regulation and a quite laissez faire approach to franchise-specific legislation with stringent registration requirements, with almost every permutation in between. There are conceptual similarities between most of the regulated markets, with prior disclosure a common element, but the detail as to the nature of disclosure and the other elements of the regulatory framework is remarkably different. No two countries are sufficiently alike to provide any real efficiency for an Australian franchisor, and few of the laws are sufficiently straightforward to obviate the need to obtain specific advice from local counsel on the practical application of the law. Indeed in some countries in Asia-Pacific there can be a material divergence from franchising law and franchising practice.

India, Hong Kong, Singapore, New Zealand, the Philippines, Thailand and Japan have adopted a laissez faire approach, but they are in the minority. And even in some of these markets, notably New Zealand and the Philippines to a lesser extent Japan, industry codes of conduct have become a form of de facto regulation. Other countries have been quite prescriptive, with China, Indonesia, Malaysia, South Korea and Vietnam moving well beyond basic prior disclosure to include relationship and other elements in their regulatory framework. Macau and Taiwan favour a disclosure only model, whilst Kazakhstan stands alone as having franchise relationship requirements, but no disclosure obligations.

India, Hong Kong, Singapore and Thailand have no specific franchising regulation, and take a minimalist approach to legislative intervention in franchising matters, although India and Thailand have more restrictive foreign investment laws that can significantly impact international franchising. Legislation is under consideration in Thailand. The Philippines and New Zealand have voluntary regimes conditional upon optional membership of the franchise association, whereas China, Indonesia, Kazakhstan, Macau, Malaysia, South Korea, Taiwan and Vietnam have more comprehensive regulatory frameworks. Japan sits in between, with some regulatory requirements as well as having a code of ethics specified by the Japan Franchise Association. There are conceptual similarities among the regulatory regimes, but it is quite striking how each country has taken a different approach to the regulation of the franchise sector.

The purpose of this paper is to provide an overview of the regulatory environments in Asia for Australian and New Zealand franchise systems considering international expansion. The paper is not intended to provide a comprehensive outline of the laws affecting franchising, nor an exhaustive analysis of the relevant specific franchising laws. The intent is to describe the general nature and features of the regulatory environment, and provide a framework for further investigation using experienced Australian and local counsel. It is also beyond the
scope of this paper to consider the trademark, taxation, foreign investment and other laws likely to apply, particularly as the application of these laws may often depend on the nature of the underlying business and the franchisor’s chosen corporate and business structure.

Franchising throughout Asia has significant pitfalls. Australian franchisors need to appreciate that the legal systems throughout the Asian region can be fundamentally different not just in sophistication, but in underlying structure. Australia has a legal system based on the English common law, and underpinned by democratic principles and values. Some other countries in the region are not democracies, or may have legal systems based on the European inquisitorial system. Corruption can be a significant issue in some countries, and there can be material differences between franchising law and franchising practice.

Trademark and intellectual property protection is an important first step for all franchisors contemplating international expansion. Although most countries have taken significant steps to improve their intellectual property regimes, enforcement can remain challenging in some parts of Asia. Perhaps more importantly, it is critical to understand that there are differences between applicable trademark regimes that need to be considered. The most critical distinction is between those countries that adopt a system that grants protection based on “first to register”, and those that base protection on the concept of “first to use”. Australia has a first to use system, which provide some comfort to foreign franchise systems, particularly as use can be easier to establish given the global reach of the internet. In first to register jurisdictions foreign owners of intellectual property need to more actively protect their intellectual property, and face onerous consequences should they fail to do so. There are many first to register jurisdictions in Asia, so trademark protection via registrations becomes even more important than would normally be the case. Failure to register can be fatal to the use of the trademark in some countries.

3. NO REGULATION: INDIA, HONG KONG, SINGAPORE AND THAILAND

From a regulatory perspective India, Hong Kong, Singapore and Thailand are relatively uncomplicated entry markets for franchisors, as there is essentially no formal regulation of franchising in those countries. However in India and Thailand there are other regulatory challenges that will need to be navigated. These challenges are outlined below. In addition, due to the size of the Indian market and the dearth of written material on the Indian regulatory environment, the authors have included additional information concerning intellectual property protection, foreign investment and foreign currency restrictions to supplement the material on the regulation of franchising.

a. India

India is a parliamentary democracy, with a central “union” government and separate provincial or state governments. The court system has three levels. District courts in each state are at the bottom followed by high courts of each state with the Supreme Court at the top. Indians tend to be litigious and the court system is consequentially overburdened. Cases frequently run over a number of years. For this reason it is recommended that franchisors explore alternative dispute resolution measures such as arbitration and mediation and that these measures be reflected in their franchise agreements.

Cross-border franchising into India is permitted so it is not essential for a franchisor to establish an entity in India. Frequently foreign franchisors will grant master franchises or enter into development agreements with suitably qualified Indian entities in an effort to fast track their entry into and expansion within the jurisdiction. There are a number of factors, such as exchange controls, access to real estate, taxation and industry-specific foreign direct investment restrictions that will influence how a foreign franchisor enters the market.
The Indian Foreign Direct Investment Policy and the Foreign Exchange Management Act 1999 regulate foreign investment in Indian entities. Foreign investment (e.g., purchase of shares by a foreign franchisor in an Indian company) is permitted in many sectors, however, there are a number of exceptions including retail, gambling and betting, agriculture and real estate. Importantly for franchisors the prohibition on foreign direct investment in retail businesses does not apply to single brand product retailing. This exemption, introduced in 2006 permits a foreign entity to acquire up to 51% of an Indian entity which retails products under a single brand subject to prior governmental approval. The products must be sold under the same brand internationally and must be branded during manufacture.

The foreign investment restrictions in India can impact on the provisions included in a franchise agreement. In particular, a franchisor will often retain an option to purchase the franchise business from the franchisee (e.g., in the event that the franchisee receives a third party offer to purchase its franchise). When drafting agreements for use in India, the franchisor should determine to what extent it is able to buy out the franchisee’s business. It may be the case that the franchisor will as an alternative, retain a right to nominate a third party purchaser.

Exchange control is one area that has historically caused difficulties for foreign franchisors in India. Previously, governmental approval had been required for purchase of a franchise in India and for royalty payments out of India under licences where these exceeded relatively low threshold percentages of export and domestic sales by the Indian licensee. For example, trade mark licence royalties of up to 1% of the domestic net sales and 2% of exports by the licensee were automatically approved. Consistent with recent reforms targeted at encouraging foreign investment in India, these restrictions have now been removed. However, some commentators have pointed out the persistent vagueness of these laws may provide the government with scope to reintroduce application of approval thresholds applying to franchise fees and similar payments to foreign franchisors. In response to this risk, some franchisors may choose to retain payment structures that are within the approval thresholds previously applied.

Tax liability will depend on the structure adopted. Where income is generated in India by a foreign franchisor, that franchisor will be subject to withholding tax, however, the franchisor may receive credit for that tax in its home country pursuant to a double tax treaty applying between the respective countries.

If the franchisor grants the franchise from overseas it should also be careful of creating a permanent presence in India for tax purposes as this can give rise to additional tax liability in India. This could flow from sending its employees to India for extended periods to provide services such as training to franchisees.

Franchise services rendered in India by the franchisor will also attract a service tax of approximately 12%.

Trademark registration under the Trade Mark Act 1999 and associated Trade Mark Rules 2002 is recommended prior to use of a trademark in India. The remedies for trade mark infringement in India are similar to those seen in many other jurisdictions and include damages, injunctions and account of profits. The trade mark owner can also obtain orders for...

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4 Section I.7.c) Master Circular on Foreign Investment in India (No. 15/2011-12), Reserve Bank of India.
destruction of infringing product. The problems with protection of intellectual property in India do not stem from underdeveloped law, so much as from the practical difficulties associated with engaging in litigation within the overburdened and expensive Indian court system.

Restrictive or non-compete covenants are one tool that franchisors frequently employ to protect their intellectual property, confidential information and goodwill associated with a franchise where a franchisee ceases to operate the business. Section 27 of the Contract Act 1872 provides that an agreement which restrains a person from exercising a lawful profession, trade or business is void. Although Indian law on restraints of trade is frequently mentioned as a key matter to be aware of with respect to franchising in that jurisdiction, an examination of the application of that law reveals that it is substantively similar to that applying in some Western jurisdictions. The general approach taken by Indian courts can be likened to that taken in Australia. The court will take the starting position that a restrictive covenant is unenforceable. However, where in the circumstances the restraint is reasonable it will be enforceable. As is the case in Australia, the court will look at whether the provision is suitably tailored to protect the legitimate interests of the franchisor. There is judicial precedent supporting the enforceability of a provision preventing a franchisee from dealing with competing goods to those supplied by the franchisor. Provisions preventing solicitation of employees and customers of the business will generally be enforceable.

Franchisors often seek personal guarantees from the owners of a franchisee entity when granting a franchise to provide protection in circumstances in which a defaulting franchisee entity has insufficient assets to compensate the franchisor for associated loss. Pursuant to the Foreign Exchange Management (Guarantee) Regulations 2000, any guarantee provided by an Indian resident guarantor to a foreign franchisor will only be enforceable if it has been approved by the Reserve Bank of India before it is entered into. Where a franchisor is negotiating the grant of a master franchise or development rights with an established Indian company it should not be surprised if it encounters resistance on the provision of personal guarantees of that master’s or developer’s obligations.

Under the Consumer Protection Act 1986 it is possible for a franchisor to be held liable for damages suffered by a customer of a franchisee as a result of defective product. Relevant factors will include the degree of control exerted by the franchisor on the franchisee and the equipment and know how supplied by the franchisor to the franchisee in relation to the product. However, indemnity provisions in the franchise agreement can be relied on if a claim is brought against a franchisor.

Anti-competitive trade practices such as those prohibited under the Australian Competition and Consumer Act 2010 are also prohibited in India under the Competition Act 2002. Section 3(1) and (2) of the Act provide that “any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India” is void. Section 3(3) creates a presumption that horizontal agreements which do any of the following will have an appreciable adverse impact on competition:

1. fix pricing;
2. limit or control supply;
3. divide the market between competitors; and
4. constitute bid rigging.

However, that section provides that this presumption will not apply to “any agreement entered into by way of joint venture if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services”.

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Section 3(4) provides that each of the following types of vertical agreement will contravene sub-section (1) “if such agreement causes or is likely to cause an appreciable adverse effect on competition in India”:

1. tie in arrangements;
2. exclusive distribution agreements;
3. refusal to deal; and
4. resale price maintenance.

Accordingly, the wording of the provisions suggests that there will be a presumption that the prescribed horizontal agreements are void, whereas there will be an onus on the complainant to prove an appreciable adverse effect on competition with respect to prescribed vertical agreements. Although there is an apparent reversal of the onus of proof, in either case an agreement will not be void if it can shown that there is no adverse impact on competition. This differs from the law applicable in Australia that prohibits exclusive dealing conduct known as third line forcing (eg a franchisor requiring a franchisee to purchase from a named third party supplier) which applies irrespective of any adverse effect on competition. This difference and the shift of onus onto the complainant with regards to vertical arrangements, suggests that there is in theory scope for franchisors to be more prescriptive about the suppliers used by franchisees in India without obtaining regulatory approval for that conduct.

Section 4(2) Competition Act also prohibits misuse of one’s “dominant position” in the market.

b. Hong Kong

There are no laws or regulations that specifically govern pre-sale disclosure, though an industry trade group, the Hong Kong Franchising Association (“HKFA”) has developed a code of ethics. The Code of Ethics requires members to make a full and frank disclosure before any binding contract is executed with a franchisee. Membership in the HKFA is optional, and HKFA not quite as prominent as industry bodies in Singapore, Australia, New Zealand, the Philippines or Malaysia. The aim of the Code of Ethics is ethical guidance rather than being an industry standard as in New Zealand and Singapore.

There are no governmental filing requirements or registrations related to pre-sale disclosure, and there are no laws or regulations that directly regulate the franchisor-franchisee relationship. Disputes arising from the franchise agreement will be subject to the common law, specifically the principles of contract law, and to the legislation relating to the registration, licensing and protection of intellectual property rights, such as the Trademarks Ordinance, the Trade Descriptions Ordinance, the Copyright Ordinance, the Registered Designs Ordinance, and the Patents Ordinance.

c. Singapore

There are no laws or regulations that specifically govern franchise disclosure documents. The industry is primarily regulated through the principles of contract law, with some involvement from the national franchise industry group, the Franchising Licensing Association of Singapore (“FLAS”). Membership in the FLA is not mandatory, but FLAS is quite active and prominent with strong links to Government and membership is strong.

The FLAS has developed a Code of Ethics (the “Code of Ethics”) as guidance for its members. The Code of Ethics contains provisions on misleading promotion, full information on investment requirements, disclosure, legal advice, contracts regarding existing franchisees, trademarks, training, termination with good cause, and dispute resolution. It further states that pre-sale disclosure should be made at least seven days prior to execution of the franchise agreement. The disclosure should include details of the current operations,
investments, performance records (balance sheets and P/L statements) and any other information reasonably required by the franchisee that is material to the franchise relationship. There is no requirement to update the disclosure document after disclosed to a franchisee.

Some franchise agreements can be considered to be technology transfer agreements. Technology transfer agreements are no longer required to be registered with the Documentation, Information, and Technology Transfer Bureau if they comply with the provisions of, and/or include the stipulations/conditions required by Sections 87 and 88 of the Intellectual Property Code.

There are no laws or regulations that directly regulate the franchisor-franchisee relationship. The general principles of contract law and the Code of Ethics, if the franchisor has joined the FLAS, will apply.

d. Thailand

There are currently no disclosure requirements. However, Thai franchise law and particularly Thai disclosure law may change considerably if the new Franchising Business Act (also known as the Retail and Franchise Act) (“the Act”) is passed. If this Act is passed, franchisors must reveal all ‘necessary’ information within sixty days of signing the franchise agreement, (‘necessary’ is yet to be defined). However, even under the most recent draft of the Act, which requires disclosure, there is no explicit requirement that the disclosure must be made before the signing of a contract. The current draft of the Act remains fairly vague.

Thailand currently has no governmental filing requirements. However, if the new Act is passed, it is possible that a foreign-owned company (or a company where the majority ownership belongs to foreigners) would only be permitted to conduct a franchising business if it had obtained approval from the Thai Ministry of Commerce. Under the proposed Act, a franchisor will have to overcome various conditions before any offer of a franchise in Thailand will be permitted. For example, the franchisor will be required to have conducted its business for at least two years and must have been earning a profit from a minimum of two existing branches for at least two accounting years. Once this is satisfied a potential franchisor will also have to apply for a license to operate a franchise business.

There is currently no specific law that regulates franchise agreements or the franchise relationship in Thailand, but the Act will do so if enacted. The general principles of contract law and bargaining in good faith are applicable to the offer and sale of franchises.

To avoid misrepresentation of the franchisor-franchisee relationship to be an agent-principal relationship, an explicit statement must be made in the franchise agreement that the relationship arising from the agreement could not by any means be interpreted as an agent-principal relationship.

For the period following the expiry of the contract, the interpretation of the Thai courts is that the confidentiality clause and the competition clause may last, after termination of the agreement, for a period of up to five years with limited jurisdiction (e.g. within Thailand). Otherwise, it will be deemed as unfair and unenforceable.

Under the terms of a franchise agreement, a franchisor may restrict a franchisee’s ability to transfer its franchise or ownership interests, as long as the restriction was initially agreed upon in the contract.
4. INDUSTRY SELF-REGULATORY MODEL: NEW ZEALAND AND THE PHILIPPINES

New Zealand and the Philippines do not have specific franchising legislation. In both countries the national franchising associations have developed what they term "codes of ethics" which bind their members and provide a form of self-regulation of the sector. Membership in the association is voluntary and only franchisors that belong to an association are bound by its guidelines.

In the Philippines, the Philippine Franchising Association ("PFA") requires its members to abide by a Code of Ethics comprising a number of Fair Franchising Standards. In New Zealand, the Franchise Association of New Zealand ("FANZ") has established a Code of Ethics and Code of Practice. FANZ takes the Code of Practice seriously, with a scrutineer engaged by FANZ to vet compliance by members. In 2008 the New Zealand government considered whether to introduce franchising legislation, but decided against the idea after the majority of submissions it received supported maintaining the system of self-regulation.

a. New Zealand

Australian franchise systems will find the New Zealand system of self-regulation very similar to the Australian model, but less prescriptive and of course without the force of law.

There is no registration requirement in New Zealand in relation to franchising.

In New Zealand, the disclosure timing requirements are set out in the FANZ Code of Practice. Before the sale of any franchise can proceed, the franchisor must obtain from the prospective franchisee certification that they have read the Code of Practice and Code of Ethics, as well as the particular franchisor’s disclosure document. The Codes must be supplied to the prospective franchisee at least seven days before sale.

A list of information to be contained in the disclosure document and the preferred (though not compulsory) order for its layout can be found in the appendices to the FANZ Code of Practice. The list is much more prescriptive in terms of the details to be disclosed, but substantially covers the same information as the Philippines. Some of the information that the franchisor is expected to disclose includes information relating to the main features of the franchise, a tabulated list of items making up the franchise purchase and estimated costs, financial requirements of the franchisor, details of existing franchises including the contact details of existing franchisees, and financial projections of potential profit, among other things.

The franchisor must sign a certificate declaring its belief in the company’s solvency. Certain key financial data must be supplied and presented in the specific format of a franchisor Financial Data Certificate, which must also be signed by the franchisor.

There is no specific legislation to impose franchise relationship requirements in New Zealand, but the franchising guidelines provide that members must act in good faith and honestly.

In New Zealand the Fair Trading Act 1986 regulates various aspects of trade and applies to all businesses. However, certain provisions can have particular application to franchising. The most important provisions are sections 9 and 22. Section 9 contains a general prohibition on misleading or deceptive conduct in trade or commerce, and section 22 provides that it is an offense to make a false or misleading statement with respect to the profitability, risk or any other material aspect of a franchise during the course of inviting persons to engage or participate in the franchise. These sections are very similar to, and...
have been based upon, the prohibitions contained in the Australian Competition and Consumer Act.

The FANZ ethical guidelines also can apply to conduct. The guidelines provide that the parties must act in an honest manner. Further, franchisors and franchisees must avoid behaving in a way that would cause detriment to each other’s business. Conduct that is detrimental includes conduct that is unnecessary and unreasonable in respect of the risks it poses to one party, conduct that is not reasonably necessary to protect the parties’ legitimate business interests, and conduct that breaches the franchising guidelines. These are very similar to the Member Standards of the Franchise Council of Australia.

Although these ethical guidelines do not have the force of law, breach may lead to brand damage, and it is possible that a claim could be made that behaviour that flagrantly breached the guidelines could constitute misleading or deceptive conduct. For this to occur a franchisor would probably have to make an express or implied representation that it would comply with the FANZ guidelines. Mere membership of FANZ would probably not be sufficient.

b. The Philippines

In the Philippines, the PFA’s Code of Ethics imposes pre-sale disclosure duties on the franchisor. At least thirty days prior to sale, the franchisor is obliged to disclose the franchisee’s investment requirements. The level of disclosure required is “as much detail as necessary to avoid being misleading.” The franchisor must specify whether the stated investment requirement is the total or partial cost of the franchise and the items included in the stated amount.9

Within a reasonable time before the sale, disclosure must be made about the franchise’s current operations, performance records and potential profits. The prospective franchisee is further entitled to any information that is “material” to the franchising relationship during this period. The material information must be disclosed to them at least fifteen days before sale.10

At least fourteen days in advance of the agreement being signed, the agreement must be disclosed to the franchisee and its significant provisions must be accompanied by a written explanation of their meaning. In addition, the Fair Franchising Standards expressly require the franchisor to encourage the prospective franchisee to seek adequate legal and financial advice. The gathering of information about the franchisor and franchise business from existing franchisees must also be encouraged.

The Fair Franchising Standards provide that the franchisor must supply a Franchise Offering Circular (“FOC”) at least thirty days before signing a franchise agreement. The FOC obligations are similar to those contained in the Australian Franchising Code of Conduct, although not quite as extensive.11

The disclosure document must include a clause encouraging the prospective franchisee to seek legal and financial advice. The wording for this statement is set out in the Code of Conduct. A franchise agreement cannot be signed until the franchisee has certified that the franchise agreement has been explained to the franchisee by a solicitor.

In the Philippines, there is no franchisor registration system or filing requirement concerning franchise agreements. However some franchise agreements and master franchise agreements will be considered to be technology transfer arrangements, and therefore will be

9 Section IV, Code of Ethics, Philippine Franchise Association.
10 Id.
subject to certain restrictions on non-competition, transfer or non-renewal. The main focus or purpose of the provisions is to protect the local Philippine trade and business from anti-competition and anti-trade practices. Typically, franchise agreements and the master franchise agreement are submitted to the Intellectual Property Office’s Bureau of Documentation, Information and Technology Transfer for conformity clearance and/or for an exemption request from the provisions of Section 87 and 88 of the Intellectual Property Code.

In the Philippines, the general law that applies to all retail traders, the *Retail Trade Act*, contains rules about foreign equity participation. Section 5 states that a foreign retail store must secure a certification from two government authorities, to confirm it has remitted the minimum required capital investment, before it can commence trade. Section 8 prohibits a foreign retailer from trading unless it has met specified conditions. Its parent corporation must have the prescribed minimum amount of net worth, it must have a minimum of five franchises already in operation, or one store capitalized at a minimum of twenty-five million US dollars, and a five year track record in retailing. The Philippine Department of Trade and Industry keeps a list of retailers that qualify in meeting the specific conditions and monitors the parent company to ensure it meets the capitalization requirements.

In the Philippines, the guidelines provide that members must act in good faith, but qualify the requirement by stating that it is not intended to alter the franchise agreement. The franchisor and the franchisee must act fairly in their contractual dealings with one another and, where reasonable, the franchisor must inform the franchisee when the franchisee is in breach of the franchise agreement and allow the franchisee a reasonable time to remedy the breach. The Philippine regulations have a clause relating to communication, which states that a franchisor must be conveniently accessible and responsive to franchisees.

There are no specific franchise relationship laws in the Philippines. However, as noted, many franchise agreements and master franchise agreements will be technology transfer contracts for the purposes of the Intellectual Property Code. The Intellectual Property Code provides that technology transfer contracts should not have adverse effects on competition and trade, must provide for effective quality control by the licensor over the product or service covered by the contract, and must allow continued access to improvements in the transferred technology. The Intellectual Property Code provides that certain clauses will *prima facie* be considered to have an adverse effect on competition and trade. Section 88 also contains mandatory provisions that must be included in voluntary license contracts. Finally, there are various other provisions in the Intellectual Property Code that may be relevant to a master franchise agreement.

The main focus or purpose of the provisions is to protect the local Philippine trade and business from anti-competition and anti-trade practices. Most master franchise agreements will not be of great concern, but it is prudent to submit a master franchise agreement to the Intellectual Property Office’s Bureau of Documentation, Information and Technology Transfer for conformity clearance and/or for an exemption request from the provisions of Section 87 and 88 of the Intellectual Property Code.

Section 92 of the Intellectual Property Code provides that if a technology transfer contract fails to conform to the provisions of Section 87 and 88, the whole agreement is automatically rendered unenforceable, unless an exemption clearance is obtained pursuant to the provisions of Section 91.

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12 Section 3, Code of Ethics, Philippine Franchise Association.

5. FRANCHISE RELATIONSHIP MODEL: KAZAKHSTAN

Kazakhstan is unlikely to be a priority destination for Australian franchisors, but is included for the sake of completeness given it is a regulated market and is located in Asia.

There are no specific pre-sale disclosure requirements in Kazakhstan, and no specific government filing requirements in Kazakhstan.

The Republic of Kazakhstan’s Law on Complex Business License (Franchising) (“the Law”) is a franchise relationship law that was adopted on June 24, 2002. The Law is quite prescriptive in relation to the content of the franchise agreement. A franchise agreement must provide for the use of the franchisor’s intellectual property, business reputation and commercial experience with or without indicating a territory. It may also provide for other typical commercial arrangements. The franchise agreement must be in writing and be signed by the parties, and it must identify whether the agreement is for a definite or indefinite term. The Law provides various matters that can be included in the franchise agreement, but the parties can contract out of these obligations.

The franchisor has a right to compensation for its damages if the franchisee discloses any of the franchisor’s confidential information without its consent. If either the franchisor or the franchisee violates the Law, they will be held responsible in accordance with the law of Kazakhstan. Disputes between the franchisor and the franchisee must be settled in accordance with the laws of Kazakhstan.

6. FRANCHISE DISCLOSURE MODEL: JAPAN, MACAU AND TAIWAN

Australia, Japan, Macau and Taiwan share a common conceptual framework for pre-contractual disclosure that does not involve any registration element. The nature of items to be disclosed is also conceptually similar in each of these countries, and conceptually similar to those required in the United States. Franchisors must make disclosure concerning business history, business experience, any litigation or bankruptcy, establishment costs, operating costs and key agreement provisions.

a. Japan

Japan is relatively laissez faire, with guidelines on franchising focused essentially on pre-contractual disclosure and the competition law aspects of the franchise relationship. There are no relationship implications.

Japanese franchise law is derived from the Medium-Small Business Retail Promotion Act and associated Ministerial Order (which applies to a “chain store”), and the Guidelines on Franchising (“the Guidelines”) under the Anti-Monopoly Act (which applies to a franchise). Not all franchises will be chain stores, although the definition in section 11 of the Medium Small Business Retail Promotion Act will catch many retail franchises. Under this Act a chain store is a business in which, according to a standard contract, goods are continually sold, directly or by a designated third party, and assistance over the operation is continually given, principally to medium or small-sized retailers. There are related definitions of “medium or small-sized,” and there is an official commentary published by the Small Business Agency.

There is a definition of a franchise agreement in the Guidelines that is somewhat imprecise, as it refers to a franchise agreement “generally” including certain clauses licensing a trademark or trade name, controlling or guiding the franchisee to ensure uniform image toward third parties, payment of fees and termination provisions.
The legislation does not apply to franchises in the service sector, or where half or more of the franchisees do not come within the definition of “medium or small sized.” The application of the legislation to foreign franchise systems is also unclear. The law is disclosure based, but the guidelines prohibit an abuse of a dominant position if the term of the agreement is more restricted than reasonably needed for the operation of the franchised business and the franchisor holds a dominant position against the franchisee.

The apparent intent of the definition is that the guidelines apply where there is an imbalance of power, as opposed to a situation where two corporations are contracting. The disclosure guidelines are somewhat imprecise, with the Anti-Monopoly Act sanctions essentially concerned with competition and consumer law breaches rather than franchising breaches as such. Essentially, the guidelines indicate what might breach the general prohibition on making a deceptive customer inducement.

In Japan there is a general duty of disclosure, and the guidelines on franchising contain provisions for the disclosure of necessary information at the time of the offer of a franchise and address competition law issues associated with vertical restraints between a franchisor and its franchisees. There is no specified time limit for disclosure to be provided other than it should be made before concluding a contract with a franchisee. The Guidelines provide that a disclosure document must be delivered sufficiently in advance to enable a franchisee to make an informed decision, with the Japan Franchise Association in its voluntary rules specifying the period as at least seven days. The Japanese franchising Guidelines provide a list of examples of the items to be disclosed, and the Japan Franchise Association produces a sample form disclosure document that is commonly used.

There are no governmental filing requirements in Japan. Franchisors are not required to register, and there is no state or provincial regulation of franchising in Japan.

In Japan there are no relationship provisions in the franchising guidelines, with matters to be addressed by the general law applying to business contracts. However, the guidelines contain some competition law requirements that apply in the context of a “dominant position.” This term is quite broadly defined and extends beyond the normal concept of market dominance to a situation where a franchisee would be faced with difficulties if the transaction with the franchisor were to be terminated. In such circumstances there is a general requirement for any vertical restraints imposed by a franchisor upon its franchisees to go no further than is needed to operate the franchised business, and restraints on the sources of supply, quotas on the amount to be purchased by a franchisee, requirements to offer services that are not prescribed in the franchise agreement and a prohibition to engage in a competing business after the termination of the franchise agreement to a greater extent than is necessary for the protection of the know-how provided by the franchisor, can be considered to be an “abuse of a dominant position”, which is listed as an unfair trade practice. Price fixing is also illegal in Japan.

b. Macau

Macau has specific franchising requirements contained in the Macau Commercial Code that extend beyond disclosure to the franchise relationship by explicitly recognizing a good faith obligation and expectation.

In Macau a franchising contract is that by which one of the parties, against a direct or indirect payment, grants to the other, in a certain zone and in a stable manner, the right to produce

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14 Commentary and analysis on Macau’s franchise regulation is difficult to obtain. The authors would like to acknowledge the useful information contained in www.chinabusinesslaw.com.blogspot from which much of this portion of the paper has been derived.
and or to sell certain goods or services under his entrepreneurial image, according to his know-how, with his technical assistance, and subject to his control.\textsuperscript{15}

In Macau there is no specified time limit for disclosure to be provided, but the prospective franchisee must receive “adequate advance disclosure.” Some commentators consider the Chinese thirty-day period may provide useful guidance on this issue because the Macau legislation has considerable similarity to the more comprehensive Chinese franchise legislation.\textsuperscript{16}

The legislation lists topics that need to be covered in the disclosure document. The list is similar to those included in the Australian Franchising Code of Conduct, although not quite as comprehensive.

There are no governmental filing requirements in Macau and franchisors are not required to register. The Macau Commercial Code (“MCC”) recognizes a contractual duty of good faith and fair dealing. It would be expected that in the franchise relationship the franchisor allow the franchisee quiet enjoyment of the franchisor’s intellectual property and provide adequate training, conduct advertising and supply the necessary goods or services required by the franchisee. There would be an expectation that the franchisor inform the franchisee of any system changes, update the franchise system to ensure its competitiveness, not compete with the franchisee without agreement and provide consideration to the franchisee for any post-term non-compete or non-disclosure obligations. Any tying arrangements would be limited to goods and equipment core to the franchise system, and implied warranties would apply to such goods and equipment.

Similarly, a franchisee would also be expected to perform its duties in good faith, by paying royalties to the franchisor, using the intellectual property in accordance with the terms of the franchise grant, maintaining uniformity and quality, providing requested business information, allowing franchisor inspection and so forth.

The MCC requires that a franchise contract must be in writing, and its term should be no shorter than three years if a term is fixed. Absent an agreed term, the contract is presumed to last for an indeterminate period of time.

c. Taiwan

Taiwan has specific franchise legislation contained in the Rules on Disclosure of Information by franchisors (“the Disclosure Rules”) promulgated by Taiwan’s Fair Trade Commission. The Taiwan Civil Code and the Fair Trade Law will also apply to franchise agreements.

In Taiwan disclosure must be provided ten days prior to signing the franchise agreement. The franchisor must provide the franchisee with a copy of the franchise agreement for review at least five days before the parties are to enter into any agreement relating to the franchise.

The regulatory requirements in Taiwan focus on compliance with the substance of disclosure, and do not have specific requirements as to the form of the disclosure document. The content to be included is conceptually similar to, but not as comprehensive or prescriptive as, in Australia. However, Taiwan extends the typical disclosure requirements by requiring franchisors to describe in relation to the franchise territory any territorial exclusivity or rights, circumstances under which exclusivity might be lost, any non-competition policy between franchisees and any restrictions on the franchisee’s ability to use the internet or other means to promote goods and services.

\textsuperscript{15} See Article 679, Macau Commercial Code

\textsuperscript{16} Eg: www.chinabusinesslaw.com.blogspot.
There are no governmental filing requirements in Taiwan and franchisors are not required to register.

Taiwan has no explicit franchise relationship obligations in its franchising regulations. Article 24 of the franchising guidelines contains a general prohibition that will have application to franchising. A party must not engage in any deceptive or obviously unfair conduct that is likely to affect fair trading order, being the orderly unrestricted and competitive operation of the market. Such conduct would include abuse of market power, price fixing, collusion and general deceptive or obviously unfair conduct.17

7. FILING AND DISCLOSURE: CHINA, INDONESIA, MALAYSIA, SOUTH KOREA AND VIETNAM

There are a handful of countries that require both pre-sale disclosure and governmental filings in connection with the offer and sale of franchises. The countries with such requirements are China, Indonesia, Malaysia, South Korea and Vietnam. Three of the five countries – Malaysia, South Korea and Vietnam – require a filing before a franchise sale is made. The other two – Indonesia and China – require a filing of the Franchise Agreement after the sale is made. Each of these countries also has differing relationship requirements.

(a) China

China has a unitary governmental system structured as a central government having control over a second level of government comprised of local authorities in the various provinces, regions and municipalities. The Chinese judicial system is comprised of four levels with the Supreme People’s Court at the top, followed by the Higher Level People’s Courts, the Intermediate Level People’s Courts and finally the Basic Level People’s Courts. Contrary to the expectations of some foreign franchisors they are generally treated the same as domestic franchisors in Chinese courts. This may in part reflect the heavy focus but the Chinese government on preventing fraud at the local level.

Foreign investment in China is restricted to varying degrees depending on the industry sector in which the foreign entity wishes to invest and the type goods or services the business will supply. Foreign investment is classified as encouraged, restricted or prohibited. The Catalogue for the Guidance of Foreign Investment Industries sets out the classifications and which activities fall within each class. Investment in the retail sector can be either encouraged or restricted depending on the products sold18.

The Administration of Commercial Franchise Regulations and the related Administration Rules on Commercial Franchise Filing and Administration Rules on Commercial Information Disclosure are the main franchising specific laws in China. The Regulations came into effect on 1 May 2007 and are administered by the Ministry of Commerce (“MOFCOM”) and its provincial counterparts.

Prior to commencement of franchising in China a franchisor must satisfy the “2 + 1 Rule”19 - The franchisor must own at least 2 franchise units and have operated them for at least 1 year at the time of filing for registration. The 2 existing units can be located anywhere in the world. Although it is not clear from the Regulations, it is likely that units operated by affiliates of the franchisor can be included.

17 Unfair conduct is analogous to the Australian concept of unconscionable conduct.
19 Article 7 of the Regulations.
Foreign franchisors must register with MOFCOM and Chinese franchisors must register with the provincial counterpart of MOFCOM in the province in which they are located within 15 days following execution of the first franchise agreement. The materials that must be filed are set out in Article 5 of the Filing Rules. These materials will include:

1) Basic information regarding the franchise.
2) Locations of all franchised stores in China.
3) Franchisor’s marketing plan.
4) Copy of the franchisor’s business licence or equivalent (e.g. certificate of incorporation).
5) Copy of each registration certificate for registered trademarks, patents and other similar resources relevant to the franchise system.
6) Evidence of satisfaction of the “2 + 1 Rule” which will, for units located outside of China, include notarized and legalized copies of relevant business registration certificates and like documents.
7) The franchise agreement.
8) The table of contents of the operations manual.
9) Where separate regulatory approvals are required based on the nature of the goods or services provided by the franchise, documents evidencing these approvals.
10) The franchisor’s undertaking signed by a representative of the franchisor.

Before a franchisor can commence franchising in China it must have all of the necessary business resources to carry on the franchise in that jurisdiction including those necessary to provide training and support to its franchisees. Registration of the relevant trademarks is one prerequisite that can result in significant delays for a franchisor wishing to enter this market due to the lengthy processing times at the Chinese trade marks office. It is recommended that franchisors looking at commencing operations in China lodge applications for registration of the relevant trade marks as early as possible. In this regard, it is important to note that due to language differences the Western trade marks associated with a franchise system may not be appropriate for use in identifying the system to Chinese consumers. For this reason, registering a Chinese language version of the trade mark (in addition to the original mark) is often recommended.

Article 7 of the Filing Rules provides that modifications to the filed materials must be notified to the authority within 30 days following the modification. Since the filed materials include the locations of each franchised store in China, Article 7 arguably requires a filing every time a new franchise store is opened. Article 19 of the Regulations also requires the franchisor to, in the first quarter of each year, provide notice of the status of the franchise agreements that it signed during the preceding year.

Prior to 31 March each year, the franchisor must report any conclusion, rescission, extension and modification of the Chinese franchise agreements to which it is or was a party which occurred in the preceding year.

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20 Article 6 of the Filing Rules.
21 Article 8 of the Filing Rules.
The franchisor must make disclosure to a prospective franchisee at least 30 days prior to execution of a franchise agreement\textsuperscript{22}. There are twelve main areas of disclosure as follows:

1) Basic information on the franchisor including its franchising activities.

2) Basic information regarding the franchisor’s resources necessary for the conduct of the franchise. This includes the details of any relevant intellectual property and any disputes relating to the same.

3) Basic information regarding fees payable by the franchisee.

4) Pricing and terms of supply of goods and services the franchisee will acquire. This includes any restrictions on the suppliers that the franchisee may use.

5) Details of the training and support services that the franchisor will supply.

6) Method and content of guidance and supervision on franchisee’s operation.

7) Estimated start-up expenses/investment.

8) Information regarding the existing franchisees in China. This will include actual or estimated average performance figures.

9) Past 2 years audited financial reports of the franchisor.

10) Material litigation and arbitration history for the franchisor for the preceding 5 years. Litigation or arbitration will be material if it involves an amount of 500,000 renminbi or more.

11) Record of material illegal operation of the franchisor or its legal representative. Here, fines of 300,000 – 500,000 renminbi or findings of criminal liability are material.

12) The sample franchise agreement.

Where a sub-franchising (or master franchising) structure is adopted there is, unlike in Australia, no obligation on the head franchisor to make disclosure to the franchisee. However, the sub-franchisor must, in addition to its other disclosure obligations provide the franchisee with the information that was disclosed to it by the head franchisor in relation to the grant to it by the head franchisor. In order to avoid having to comply with disclosure and other requirements under the Chinese franchising laws, some foreign franchisors have entered into master franchise or similar agreements with Hong Kong affiliates of the intended Chinese operating entities. As set out earlier in this paper there are no franchising laws or regulations in Hong Kong. Accordingly, this practice by foreign franchisors passes the burden on compliance onto the master or developer and its affiliates.

The franchisor must disclose material changes in the information previously disclosed to the franchisee in a timely fashion\textsuperscript{23}. Unfortunately, unlike the section of the Australian Code which requires ongoing disclosure of materially relevant facts, the Regulations do not prescribe what a “material” change is. There is also no further indication as to what will be considered “timely” disclosure.

The areas that a franchise agreement must cover are set out at Article 11 of the Regulations. Each of these areas are usually covered in the franchise agreements ordinarily used in jurisdictions such as Australia.

\textsuperscript{22} Article 21 of the Regulations and Article 4 of the Disclosure Rules.

\textsuperscript{23} Article 23 of the Regulations
Article 13 of the *Regulations* provides that franchise agreements must be for a term of not less than three years, unless otherwise agreed to by the franchisee. The effect of this provisions is questionable given that in almost all cases the term will be set out in a written agreement signed by the franchisee. This “minimum term” provision does not apply to renewals.

The franchise agreement must provide for a cooling off period, however, the applicable article of the *Regulations* does not specify how long this period must be. It may be that a cooling off period similar to that under the Australian Code (i.e. 7 days) will suffice.

The *Regulations* contain a number of provisions which impact on the franchisor-franchisee relationship during the term of the franchise agreement. These include provisions dealing with support provided to the franchisee, transfer of the franchise, disclosure of expenditure of advertising fees and maintenance of confidentiality of franchisor information.

Article 4 of the *Regulations* provides that franchising activities shall be conducted in compliance with the principles of free will, fair dealing, honesty and good faith. The Chinese *Contract Law* which will apply to parties to a franchise agreement also contains an obligation on contracting parties to fulfill their obligations in good faith. An example of a circumstance in which Article 4 could apply is where a franchisor has knowingly provided misleading information to induce a franchisee to enter into a franchise agreement.

The right of the parties to agree to provisions dealing with termination of the franchise agreement is not restricted by the franchise laws. Early termination by either party is permitted in accordance with agreed terms of the franchise agreement.

Renewal is also not specifically regulated.

A number of other Chinese laws should be carefully considered by franchisors looking to move into that market.

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24 Article 12 of the *Regulations*

25 Article 60
The *Enterprise Income Tax Law* provides that resident enterprises will pay income tax at a rate of 25% on all income. Non-resident enterprises must pay withholding tax at a rate of 10% on passive income originating from China (e.g., royalties). The foreign franchisor may receive a credit for this tax in its home country in accordance with any applicable double tax treaty. Importantly, withholding tax does not apply to active income (e.g., payment for training, support, and other services provided). For this reason, many cross-border franchisors have endeavored to classify payments out of China as payments for services rather than passive royalties.

Foreign exchange controls can restrict or delay payment by the franchisee of fees to foreign franchisors in non-Chinese currencies. The controls may require the franchisee to provide its bank with certain documents evidencing the requirement to make the payment (including the franchise agreement) before that bank can process the conversion of the franchisee's renminbi into the franchisor's native currency for overseas transfer. Delays experienced can be significant where the documents to be provided to the bank require prior registration.

The Chinese *Anti-Unfair Competition Law* and the *Anti-Monopoly Law* prohibit or restrict anticompetitive conduct such as fixing resale prices, setting minimum pricing and allocation of portions of markets by agreement between competitors. However, restrictions can be placed on franchisees using certain suppliers provided this is not considered an abuse of market power, adverse to the public interest or adverse to the franchisee's lawful business activities.

(b) **Indonesia.**

Government Regulation No. 42 of 2007 ("GR 42") governs franchising in Indonesia. Regulation 31, issued in 2008, is the implementing regulation issued by the Minister of Trade.

Regulation 31 defines a "franchise" as "an exclusive right owned by individuals or business entities of a business system with unique business characteristics in the framework of marketing goods and/or services which have been proven successful and can be utilized and/or used by other parties on the basis of franchise agreements." This arguably imposes significantly more onerous obligations in relation to proof of concept, and is intended to ensure concepts introduced to Indonesia are of substance and cater for the needs of the Indonesian people, including potential franchisees. Regulation 31 requires that a "franchise":

- Have unique business characteristics or distinctiveness;
- Already be proven profitable;
- Have a written standard (or manual) of the offered service and of the goods/services;
- Be easy to teach and apply;
- Have continuous support from the franchisor;
- Have registered intellectual property rights.

Under Regulation 31, a disclosure document must be given to prospective franchisee two weeks prior to the execution of franchise agreement. It is worth noting that the triggering event for disclosure in Indonesia is the execution of the franchise agreement and not the payment of money. The regulations are not specific as to whether a disclosure document is required to be given prior to signing a letter of intent.
Attachment I of Regulation 31 requires franchisors to provide a prospective franchisee with disclosure, and contains a quite extensive list of matters to be disclosed. The list appears to be based on the Australian model, and also includes a requirement to include the names and addresses of companies and/or individuals as franchisees.

In an unusual requirement, Article 6 (1) of Regulation 31 provides that on termination prior to expiration of the franchise agreement, the franchisor may not appoint a new franchisee before the franchisor and franchisee have reached agreement settling the matter by a “clean break” statement certifying that neither has any outstanding obligations or liabilities to the other, or at least six months have lapsed since termination of the franchise agreement.

A franchisor must obtain a STPW\(^\text{26}\) prior to furnishing the disclosure document to a prospective franchisee. Under Regulation 31, the application to obtain a STPW for a foreign franchisor, subsequent franchisor and franchisee from foreign franchisor, along with the required documents, must be filed with the Department of Trade (“DOT”).

The disclosure document submitted by foreign franchisor for registration at the DOT must be legalized by a Public Notary in the franchisee’s home country and the franchisor must include a certificate from a governmental authority.

Under Articles 18 (1) of Regulation 31, if the DOT determines that the application for an STPW is complete and in order, it must issue an STPW within three business days. If the application is not complete and not in order, the DOT will reject it within three business days, and must provide the reasons for the rejection. In practice, local counsel advises the DOT normally takes longer than three business days to issue the STPW.

Under Article (2) of GR 42, if a franchise agreement is written in foreign language, a translation in Indonesian must be provided. As a practical matter, an English disclosure document must be completed with an Indonesian translation prepared, preferably by a sworn translator.

In the case of a termination, Article 6 of Regulation 31 requires a franchisor to obtain a “clean break” statement from the prior franchisee or the lapse of six months after termination of the franchise agreements before a new franchisee may be appointed at the location in question. The DOT will not issue an STPW to the new franchisee until the clean break statement is obtained from the terminated franchisee or the period of six months has elapsed. The clean break statement should indicate that the franchisor and the terminated franchisee have settled all problems arising as a result of the termination. Local counsel advises that a clean break statement is also required if an existing franchisee transfers its business to a new franchisee.

GR 42 and Regulation 31 also specify that certain matters must be included in the franchise agreement. GR 42 requires Indonesia law to be applicable to franchise agreements.

(c) Malaysia

In Malaysia the Malaysia Franchise Act 1998 governs franchising. A franchisor must provide a franchise agreement and disclosure document at least ten days before execution of the franchise agreement. The format of the disclosure document is provided in Form 1 of the Regulations, and the comprehensive content requirements are similar to that required under the Australian Franchising Code of Conduct. As in Australia the proposed form of franchise agreement must be included in the disclosure document.

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\(^{26}\) *Surat Tanda Pendaftaran Waralaba*, which is a form of Government consent.
In an unusual requirement, which presents potential risks to franchisors, the franchisor is required to provide in Section 18 of Form 1 the financial forecast for three years. “Financial forecast” is not defined, but the common view is that it refers to the projected profits and losses of the franchise business. Local counsel advises that the franchisor can safeguard its interest by stating that the forecast is made based on various assumptions and that it is not intended to be a sales performance guarantee in any way.

Under Section 6(1) of the Act, a foreign and local franchisor must register its franchise offering with the Registrar of Franchises before making any offer for sale of the intended franchise. A foreign franchisor typically applies for franchise registration by submitting a request in written form, usually in the form of a letter of request for registration of the franchise. The letter should contain detail about the franchisor and the franchise. Section 7 of the Act requires a franchisor, when making application to the Registrar, to submit the prescribed form together with a completed disclosure document, a sample franchise agreement, the operations manual, the training manual, a copy of the latest financial statements and such other information as the Registrar may require. Notwithstanding section 7, the disclosure document need not always accompany the application, and the manuals may be able to be provided for inspection but not lodged.

Under Section 8 of the Act, the Registrar will provide written notice of its approval or refusal of the registration application. After receiving the application and prior to approval, the Registrar may request additional documents or information. Registration typically takes four to five months for the Registrar to approve an application. Upon obtaining approval, the foreign franchisor can offer the franchise for sale, provide the necessary disclosure document to the prospective franchisee and sign the franchise agreement.

If a registration application is refused, the Registrar will provide reasons for the refusal. A franchisor has the right to appeal to the Minister within one month of the date of receipt of the notice of refusal. The Minister’s decision is final. The Registrar may refuse a registration application under Section 54(2) of the Act without giving any reason for refusal.

Section 10 of the Act states that the franchise registration remains effective unless the Registrar issues a written order notifying the applicant or franchisor of suspension or termination of the sale or registration of the franchise.

English is typically acceptable, as the Act and Regulations do not stipulate any particular language requirements for the disclosure document or franchise agreement. Under Section 16 of the Act, a registered franchisor must file with the Registrar an annual report containing an updated disclosure document, if any, and a completed Form 6 as required by the Regulations, accompanied by a copy of the franchisor’s most recent audited financial statements.

Section 18 of the Act requires a franchise agreement contain certain minimum requirements or provisions, the failure of which renders a franchise agreement null and void. Section 18 requires that a franchise agreement must contain the name and description of the product and business of the franchise, territorial rights, required payments, franchisor and franchisee obligations, intellectual property rights, assignment conditions, a cooling-off period, a description of the intellectual property, the type of assistance provided, the term, renewal rights and the consequences of termination or expiration.

Section 31 of the Act stipulates that a franchise agreement cannot be terminated by the franchisor without “good cause.” “Good cause” is defined. In the event the franchisee fails to comply with the terms of the franchise agreement, the franchisor can terminate by giving written notice and not less than fourteen days to remedy the breach. The franchisor can also terminate without giving notice to remedy if the franchisee assigns the franchise rights for the

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27 Section 17 of the Act.
benefit of creditors, voluntarily abandons the franchised business, is convicted of a criminal offense which substantially impairs the goodwill associated with the franchisor’s mark or other intellectual property, or the franchisee repeatedly failed to comply with the terms of the franchise agreement.

A franchisor that refuses to renew or extend a franchise at the end of its term must compensate the franchisee. Under Section 32 of the Act, under specified circumstances, the franchisor must repurchase the franchised business or provide compensation at a price to be agreed upon by the franchisor and franchisee after having taken into consideration the diminution in value of the franchised business caused by the expiration of the franchise.

Section 29 of the Act provides that the franchisor and franchisee must act in an honest and lawful manner and must endeavour to pursue the best franchise business practices under the circumstances. They must avoid substantial and unreasonable overvaluation of fees and prices, conduct that is unnecessary and unreasonable in relation to the risks to be incurred by one party and conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

Section 20 of the Act provides that it is an unfair franchise practice and a violation of the Act for a franchisor to unreasonably and materially discriminate between franchisees operating a franchise in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services if the discrimination causes damage to a franchisee and the affected franchisee is a competitor of the advantaged franchisee, unless and to the extent that any classification of or discrimination between franchisees falls into specified categories.

(d) South Korea

The South Korean franchise law is unusually detailed and complex, both due to its specific requirements and also due to the overlay of antitrust and fair trade requirements which existed prior to the law’s enactment.

A franchisor must provide a registered disclosure document at least fourteen days (seven days, if the franchisee has consulted either an attorney, or a licensed franchise dealer) prior to the execution of a franchise agreement or payment of a franchise fee. The Enforcement Decree provides that the Korea Fair Trade Commission (the KFTC) may determine and announce a standard form for the presentation of information in the disclosure documents, based on the type of industry, business or use of such information disclosed. The KFTC published a standard format for the disclosure document in July 2008. The disclosure document must include the typical details required in most countries, and is quite similar to the Australian model in terms of the detail required. Financial statements, including the balance sheet and profit/loss statements of the franchisor for the prior three fiscal years, must be included in the disclosure document.

Franchisors must file the disclosure document with KFTC for registration. The KFTC generally requires franchisors to submit all documents submitted to KFTC for registration in the Korean language. Although neither the actual franchise agreement nor any related agreement is expressly required to be included in the disclosure document, the KFTC generally requires that the franchise agreement be submitted for purposes of its review.

If a franchisor wishes to terminate a franchise agreement, the franchisor must give a cure period of not less than two months prior to the date of termination, and must notify the franchisee in writing not less than twice of the details of the breach by the franchisee. If a franchisee requests a renewal between one hundred and eighty days and ninety days prior

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28 The Enforcement Decree of the Monopoly Regulation and Fair Trade Act.
to the expiration of the franchise agreement, the franchisor may not refuse to renew the franchise agreement without “justifiable reasons.” There are quite limited reasons for refusing renewal, such as where the franchisee has failed to pay franchise fees under the Franchise Agreement or follow the following important business policies of the franchisor that are deemed necessary for maintaining the franchise. However the franchisee’s right to request a renewal may only be exercised for a total duration of ten years, including the term of the original franchise agreement. If ten years have elapsed since the execution of the initial franchise agreement, the franchisor may refuse to renew the franchise agreement without cause, provided a written notice of non-renewal has been provided by the franchisor to the franchisee within fifteen days from receipt of franchisee’s request for renewal.

The “Act on Fairness in Franchise Transactions” (“AFFT”) is the primary statute applicable to the franchisor-franchisee relationship. Additionally, the Monopoly Regulation and Fair Trade Act (“MRFTA”), and regulations promulgated by the KFTC there-under, are generally applicable to the relationship. Article 12 of the AFFT places certain restrictions on franchisors’ behaviour, which are adapted from principles articulated in the MRFTA. According to the AFFT, a franchisor shall not commit any act falling under any of the following categories, which may obstruct fair trade in the franchise business:

- “Unfair” refusal to deal;
- “Unfair” restraint or restriction;
- Restriction on sale of products or services handled by a franchisee;
- Abuse of bargaining power;
- Establishment or amendment of contract provisions placing the franchisee at an “unfair” disadvantage;
- Infringement of a franchisee’s business territory; or
- Any other activity which may seem to obstruct fair trade, such as unfairly inducing a franchisee of a competitor franchisor to transact business in the franchisee’s market (e.g., “poaching”).

Because the standard to be used in analysis of the foregoing practices is “unfairness,” local counsel advises franchisors to have a clear written statement of business objectives and rationales for a potentially unfair practice, in order that the parties and any court can have a comprehensive understanding of all relevant circumstances.

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29 A Decree by the President of South Korea.
30 AFFT, Article 13; See generally also South Korea, International Franchise Sales Laws, American Bar Association at 20-23.
31 Notable among them, the KFTC’s 1997 “Guidelines on International Contracts (“the Guidelines”) remain in effect and could potentially impact the franchisor-franchisee relationship where one of the parties is not a Korean resident. However, local counsel has been advised by the KFTC that the Guidelines have not been enforced since 1999.
32 In addition, local counsel advises the AFFT also promulgates a “code of best practices.” Under Article 4 of the AFFT, both parties to a franchise relationship must exercise good faith in performance of each of their respective duties in connection with management and operation of the franchise. The franchisor’s duties are defined in Article 5 of the AFFT and the franchisee’s duties are defined in Article 6 of the AFFT.

Articles 4, 5, and 6 of AFFT carry no sanctions, and are guidelines for best practices rather than mandatory rules. However, to the extent that a franchise agreement incorporates or restates these provisions, parties to the agreement would have the right to enforce the terms of such agreement and an aggrieved party would be likely to have rights of redress, including petition to the KFTC or civil courts. See generally South Korea, International Franchise Sales Laws, American Bar Association at 20-23.
(e) Vietnam

The Vietnamese franchise law has a regulatory model with pre-sale disclosure and registration requirements supplemented with relationship requirements. Vietnam’s franchise requirements are contained in the Commercial Law, adopted June 14, 2005 (“Commercial Law”). They are further described in Decree No. 35/2006/ND-CP of the Government dated March 31, 2006 (“Decree 35”), and Circular No. 09/2006/TT-BTM of the Ministry of Industry and Trade (“MOIT”) (MOIT was formerly known as the Ministry of Trade), dated May 25, 2006 (“Circular 09”).

The definition of a “franchise agreement” in the Commercial Law⁴³ is quite broad, and interestingly does not incorporate any “fee” or “payment” requirement.

Franchisors must register “franchising activities” prior to the offer and sale of franchise agreements. In addition, Decree 35 also requires that: (1) the business system to be franchised must have been operating for at least one year and (2) the goods and services sold in the franchise must not be on the list of prohibited goods and services.⁴⁴

Decree 35 states that disclosure be made at least fifteen working days before a franchise agreement is executed, "if the parties do not have some other agreement." The last phrase is ambiguous as to whether it permits a shorter time period, but the more conservative view is that fifteen days is the minimum and the franchisor and franchisee may only agree on a longer time. A complete draft franchise contract must be delivered together with the franchise disclosure document at least fifteen working days before the date the agreement is to be signed.

Circular 09 describes the information in the disclosure document, and is based on and therefore quite similar to the Australian Franchising Code of Conduct requirements. As in Australia, the disclosure document must also advise a prospective franchisee to do research on franchise legislation and related regulations, and must include a summary of clauses in the franchise contract that provide the conditions and obligations of the franchisor and the franchisee in connection with unilateral termination of the franchise contract. The preamble of the disclosure document must advise a prospective franchisee to: (1) look carefully at the Commercial Law, Decree 35, and Circular 09; (2) consult with existing franchisees; and (3) seek advice from independent legal, accounting, and business advisors.

A franchisor must register its “franchising activity” with the DOT before entering into a franchise agreement. A franchise agreement must be made in the Vietnamese language.⁴⁵ The franchise disclosure document must also be made in Vietnamese for filing with the DOT. The DOT has a discretion to determine whether the documentation submitted for registration meets the disclosure and filing requirements, and has the right to reject the documents or require that the franchisor make appropriate amendments or supplements to the disclosure document.

The time period within which the DOT must register the franchising activity is five working days from the date on which the franchisor submits its registration application, as long as no amendments or supplements to the registration dossier are required. However, in practice, this timing is rarely met.

Decree 35 and Circular 09 require that franchisors report to the DOT, within thirty days from the date of the change, any change in information described and registered in the disclosure

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⁴³ See Article 284 of the Commercial Law.
⁴⁵ See Decree 35. A Vietnamese translation, certified by a Vietnamese Notary Public, is required for most documents in a foreign language.
document and in other specified information. Circular 09 also requires that, before January 15th of each year, the franchisor make an annual report to the DOT on the specified matters described in the disclosure document.

The Vietnamese law has unusual termination provisions:

- A franchisor may terminate a franchise agreement unilaterally if the franchisee: (a) no longer holds a business license to carry on the franchised business; (b) is liquidated; (c) becomes bankrupt; (d) commits a serious breach of the law which breach may cause substantial damage to the goodwill of the franchise system; or (e) fails to rectify a material breach of the franchise agreement within a reasonable period of time after receipt of a written request from the franchisor; and

- A franchisee may terminate a franchise agreement unilaterally if the franchisor breaches any of its obligations enumerated in Article 287 of the Commercial Law. These obligations include: (a) to provide the franchisee with the disclosure document; (b) to provide initial training and regular technical assistance; (c) to design and arrange business outlets; (d) to grant intellectual property rights under the agreement; and (e) to treat all franchisees equally.

As in Australia, the franchisee may transfer the franchised business only with approval of the franchisor. The franchisor may refuse under certain specified circumstances. The Commercial Law provides that a franchisee has certain obligations to the franchisor, which include paying the franchise fees and other expenses stipulated in the franchise agreement; complying with the franchisor’s design and layout requirements; keeping the franchised business information confidential during and after termination of the franchise agreement; and operating in conformity with the franchise system.36

8. CONCLUSION

Australian and New Zealand franchise systems are well placed due to geography, time zone congruency and existing trading relationships to expand into Asia, particularly as US and European systems have ignored many parts of the region and opportunities therefore exist to secure market leading positions. Australian systems such as Cartridge World, Gloria Jeans, Domino’s and Cookie Man are examples of systems that have successfully expanded in the Asian region.

Cultural understanding and personal connections derived from our Asian migration and educational linkages will assist those franchisors prepared to be bold and expand regionally. There is little doubt that the future opportunities for franchising lie significantly in the emerging markets of the Asia Pacific region, with many countries already beginning to see the exponential growth in the number and diversity of franchised businesses experienced in North America in the 1980’s and 1990’s and Australia in the 1990’s and 2000’s.

Asian regulators have been quick to impose legislative requirements that regulate or affect franchising in many of the countries in the region. What is surprising is the diversity of approach. Some countries in the region – Hong Kong, Singapore, New Zealand and Japan – have adopted a laissez faire approach, but they are in the minority. And even in some of these markets, although there is no specific franchising legislation, industry codes of conduct have become a form of de facto regulation. Other countries have been very prescriptive, with Australia, China, Indonesia, Malaysia, South Korea and Vietnam moving well beyond

basic prior disclosure to including relationship and other elements in their regulatory framework. Ironically franchising appears to be flourishing ubiquitously, and irrespective of the regulatory framework.

Importantly legislative intervention is not seen as a negative. There are many countries in the Asia Pacific region that have introduced franchising legislation to enhance the credibility of the sector. Malaysia, Indonesia and Australia have quite prescriptive franchising legislation, but would regard themselves as strongly supportive of the franchise model.

The Chinese and Indian markets have particular appeal, as they have large and increasingly affluent middle classes whose demand for goods and services will fuel strong economic growth for the next decades. Each market has its regulatory challenges, but all can be navigated without major concerns with the assistance of experienced legal counsel.