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Franchising - Japan

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Supreme Court Rules on Franchisor's Duty to Disclose Information to Franchisees

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On July 4 2008 the Supreme Court rendered a highly significant judgment in a case concerning a convenience store franchise.

Facts

A Japanese franchisor with a nationwide franchise network of convenience stores entered into franchise agreements with franchisees in Japan. Under the terms of the agreement and the franchisor's payment and settlement system, the franchisees ran their stores but were unaware of the details of the franchisor's payments to the vendors from which the franchisees procured products for sale. The franchisees filed suit against the franchisor, demanding that it disclose certain information, including:

- details of the products in question;
- payment dates and amounts; and
- the names of the parties that received such payments.

Although the franchisees claimed that the franchisor had a duty to disclose certain payment details under the Civil Code, the Tokyo High Court found that no such duty exists and ruled in the franchisor's favour. However, the Supreme Court reversed the decision and remanded the case to the Tokyo High Court for further consideration.

Product Purchasing and Payment System

The franchise agreement allowed franchisees to procure products for sale from vendors of their choice. However, the franchisor recommended certain vendors, termed 'recommended vendors' in the agreement. Franchisees wishing to buy products from the recommended vendors were required to do so through the franchisor's ordering system. The franchisor purchased products from the recommended vendors and paid them; the franchisees owed payment to the franchisor, not the recommended vendor. Such payments were made using an open account.

The ordering system operated in three stages:

- A franchisee sent an order for a product to the franchisor, which consolidated orders from multiple franchisees and forwarded a single order to each of the recommended vendors.
- Each of the franchisees received products directly from the recommended vendors. The franchisees submitted certain information to the recommended vendors, including the names, numbers and quantities of the products received.
- The recommended vendors sent invoices to the franchisor, which paid the invoiced amounts and recorded the accounts receivable from the franchisees on the open account.

Under the open account system, receivables and payables between the franchisor and each of the franchisees were recorded and subsequently settled by offsetting all accounts between the parties. However, the details of the franchisor's payments to the recommended vendors - and thus the price that the franchisor paid for the products - were not disclosed to the franchisees.

Decision

The Supreme Court found that the franchisor's payments for products for sale by the franchisees should be categorized as a 'quasi-mandate' contract, meaning that it has same effect as a 'mandate' contract under Part III, Chapter 2(10) of the code.

Article 643 of the code states that "a mandate shall become effective when one of the parties mandates the other party to perform a legal act and the other party accepts the mandate".

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Article 645 states that:

"If so requested by the mandating party, the mandated party must report the current status of the administration of the mandated business at any time and must report on the process and results without delay upon completion of the mandate."

Pursuant to Article 656 on quasi-mandates, such provisions also apply to business mandates that do not constitute legal acts.

The court found that the purchase of products was essential to the franchisees' operations. Moreover, it would not have been difficult for the franchisor to inform the franchisees of the details of its payments to recommended vendors. Therefore, the court concluded that although the franchise agreement did not explicitly impose a duty on the franchisor to disclose such information to its franchisees, the agreement could be interpreted as imposing a mandatory duty (derived from Article 645) to make disclosures to the franchisees at the latter's request.

In contrast to a typical quasi-mandate agreement, the relationship in this case involved some unusual elements in relation to the performance of the mandated business, in that:

the franchisees did not pay the franchisor in advance for products delivered to them;
the franchisor did not charge the franchisees interest in respect of the period between the franchisor's payment for the goods and settlement under the open account system; and
the franchisor did not receive commission for its performance of the mandated business.

However, the court stressed that its conclusion was not affected by these factors. Rather, it made its decision on the grounds that: (i) the franchisor could increase the number of franchisees by providing the ordering and open account systems to franchisees that were unable to pay for products in advance; and (ii) the franchisor could expect an increase in franchise fees if the franchisees increased their orders under the ordering and open account systems.

The court stated generally that a franchisor is subject to a duty to report information to its franchisees, but it did not specify the information that may be withheld from franchisees. Accordingly, the specific information that must be disclosed to the franchisees will be decided by the Tokyo High Court.

Comment

It is difficult to predict the impact of the Supreme Court judgment on franchising in Japan until the Tokyo High Court renders a further decision. However, franchisors planning to do business in Japan under a franchise agreement that is substantially similar to that described above should be aware that they are highly likely to assume a duty to report certain information to their franchisees on request. Furthermore, franchisors must remember that they may be subject to this reporting duty and other duties under the code (or other laws) even if such duties are not explicitly stipulated in their franchise agreements.

For further information on this topic please contact [Kenichi Sadaka](#), [Aoi Inoue](#) or [Taisuke Yamamoto](#) at Anderson Mori & Tomotsune by telephone (+81 3 6888 5802) or by fax (+81 3 6888 6802) or by email (kenichi.sadaka@amt-law.com or aoi.inoue@amt-law.com or taisuke.yamamoto@amt-law.com).

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