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Franchising - Japan

Fair Trade Commission Investigates Convenience Store Franchisor

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On February 20 2009 Japan's largest convenience store franchisor announced that it was being investigated by the Fair Trade Commission for potential violations of the Anti-monopoly Act (54/1947).

All of Japan's major convenience stores offer lunch boxes, rice balls and sandwiches, which are profitable but perishable food products. Convenience store franchise agreements usually require franchisees to ensure that perishable food products are always fresh. Such products have strict 'sell-by' dates and the sale of out-of-date products is generally prohibited under franchise agreements.

If such perishable products are not sold before the stated date, franchisees have no choice but to dispose of them, as the franchisor is under no contractual obligation to repurchase them. Accordingly, the franchisee may incur a financial loss. As a result, some franchisees are tempted to discount foods that are about to expire, which would enable them to avoid or minimize such losses.

The act generally prevents franchisors from including provisions in their franchise agreements that expressly prohibit franchisees from discounting perishable food products without due cause. However, franchisors may be able to exert indirect influence on franchisees in order to prevent them from discounting products. Sales of perishable food products at non-discounted prices have become the norm in almost every major convenience store; products nearing their sell-by date are not discounted and substantial quantities of food are discarded.

The commission recently began to investigate this practice by conducting an on-the-spot inspection of Japan's largest convenience store franchisor. It suspected that the franchisor's actions concerning the discounting of perishable food products constituted a violation of the act.

In 2002 the commission established the Guidelines Concerning the Franchise System under the Anti-monopoly Act, which outline the general framework for franchise systems in Japan. Among other things, the guidelines set forth the following policy regarding business transactions between a franchisor and a franchisee after a franchise agreement has been signed:

"[W]hen a franchise agreement or the franchisor's actions are considered to exceed the boundaries of conduct of proper business based on the franchise system, thereby providing the franchisee with an undue disadvantage in respect of normal commercial practice, unfair trade practice under Article 19 of the act, such as Item 14 (on abuse of dominant bargaining position) of the general designation, may be applied."

The commission's investigation into the franchisor is based on its potential violation of Item 14. The guidelines concerning this item generally prohibit the franchisor from restricting the discounting of perishable food products without due cause and forcing the franchisor to discard products if the royalties paid by the franchisee are calculated on the gross profit on sales (including the cost of lost or damaged products). The guidelines state that most convenience store franchise agreements require franchisees to pay for discarded products, as well as paying royalties based on the gross profit on sales (including the cost of such discarded products), and that this method is significantly disadvantageous to franchisees.

The guidelines provide that restricting a franchisee's ability to discount perishable food products can be an unfair trade practice under Article 19. With regard to the commission's investigation into the franchisor, the key issue is whether the franchisor's action relative to the franchisee's discounting of food products constitutes an unfair trade practice. A franchisor may impose certain instructions on franchisees pertaining to products that are sold on the basis of its franchise agreement; however, restrictions that are deemed to force the franchisee to sell food products at a non-discounted price could violate the act. In a press release, the franchisor announced that while it has always conducted its business in full compliance with the relevant laws and regulations, it is nevertheless taking the commission's investigation seriously and it is cooperating fully.

The investigation is still ongoing. If the commission finds that the franchisor has not complied with the guidelines, not only will the franchisor need to change its business practices, but the sale of perishable food products by other Japanese franchises in the sector will be significantly affected. Moreover, the commission may yet decide to scrutinize other restrictions that franchisors impose on their franchisees. Some franchisees have filed lawsuits against franchisors, claiming that they have suffered damages due to the latter's alleged violations of the act. Like the investigation, such lawsuits are a reminder to franchisors to ensure that their conduct complies with the guidelines, notwithstanding the terms of

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their written franchise agreements. Moreover, franchisors must be increasingly careful about their involvement in the supervision of their franchisees' business practices.

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