

Franchising - Japan

Convenience Store Franchisor Breached Anti-monopoly Act

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On June 22 2009 the Fair Trade Commission issued a cease and desist order against Japan's largest convenience store franchisor on the grounds of abuse of dominant position under Item 14(4) of the Designation of Unfair Trade Practices,⁽¹⁾ which constitutes a violation of Article 19 of the Anti-monopoly Act (54/1947). The order, preceded by the commission's investigation, was widely reported throughout Japan (for further details please see "[Fair Trade Commission Investigates Convenience Store Franchisor](#)").

Results of Investigation and Order

The commission found that the franchisor's bargaining position was stronger than that of its franchisees. In reaching this conclusion, the commission considered the following points:

- The franchisor had 12,000 stores in Japan and the franchise's annual sales were approximately Y2.57 trillion (\$27.6 billion), whereas most of the franchisees were small or medium-sized retailers;
- The franchisor and the franchisees entered into franchise agreements for a standard term of 15 years, but with the provision that the parties could extend the franchise agreement on expiry by mutual consent;⁽²⁾
- Under the terms of the agreements, the franchisor was supposed to recommend products to be sold in the franchisees' stores, as well as the suppliers of such products - almost all of the products sold at the franchisees' stores were recommended products; and
- The franchisor supervised the management of each of the stores through an operational field counsellor, who provided advice and support in managing the stores under the terms of the franchise agreement.

As a result of these conditions, franchisees were essentially required to continue to trade with, and follow orders from, the franchisor. The commission concluded that:

- the franchisor held a dominant bargaining position in respect of the franchisees;
- franchisees were required to incur the cost of expired products under the franchisor's system; and
- the franchisor forced franchisees to discontinue the practice of discounting perishable foods, such as ready-made lunches, rice balls and sandwiches.

The order indicated that the franchise agreement gave each franchisee sole discretion to set the sale price of products sold in its store. However, it was found that the operational field counsellors, who were the franchisor's employees, prohibited franchisees from discounting perishable foods. Moreover, the commission indicated that district managers - the operational field counsellors' superiors - suggested that the franchisor would terminate the franchise agreement or take other adverse action against the franchisees if the franchisees continued to discount perishable foods. The franchisor's actions deprived the franchisees of the opportunity to reduce the costs associated with perishable foods by deciding - based on rational managerial considerations - to offer perishable foods to customers at a discount.

Thus, the commission found that the franchisor used its superior bargaining power to the franchisees' disadvantage from the viewpoint of ordinary business custom and practice. The commission found that the franchisor's actions constituted an unfair trade practice under Article 19 of the act (ie, abuse of dominant bargaining position under Item 14(4) of the Designation of Unfair Trade Practices).

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Based on Article 20(1) of the act, the commission ordered the franchisor to:

- cease all actions in violation of the act;
- convene a meeting of its board of directors and pass a resolution ordering the cessation of the unfair trade practice and determining not to engage in such conduct in future;
- inform its employees and franchisees that it would take corrective action with respect to its unfair trade practice and would provide details of its remedial plan; and
- take further action to:
 - amend its internal guidelines for employees;
 - create guidance materials for its franchisees and employees on discounting perishable foods;
 - implement periodic training for executives and employees; and
 - ensure that its legal department conduct regular audits of its compliance with the act.

In addition, the commission prohibited the franchisor from engaging in similar conduct in future.

Franchisor's Response

In a press release that was published on the same date as the order, the franchisor stated that it was taking the order seriously. It stated that although the franchisees' practice of discounting perishable foods was not applied daily, the franchisor had never entirely prohibited franchisees from discounting perishable foods. The franchisor announced that it would examine the contents of the order and decide on its future strategy.

On August 5 2009, in its press release, the franchisor announced that it had decided to accept the contents of the order.

Comment

Before the order was issued, all major convenience store chains in Japan, including the franchisor, used a model that (i) compelled franchisees to cover the cost of expired perishable food products, and (ii) instructed franchisees to sell products at prices set by the franchisor. However, in light of the order, this business model must be re-examined. In its press release dated June 23 2009 the franchisor agreed to pay 15% of its franchisees' costs in respect of expired perishable foods with effect from July 2009.

According to the order, the commission found that the franchise agreement gave franchisees sole discretion to set product prices, but that the franchisor's employees who supervised the management of the convenience stores (ie, the operational field counsellors and district managers) had violated the act. It is essential for a franchisor to provide its franchisees with uniform plans and advice relating to the business in order to ensure consistency and foster its image. However, franchisors must be careful not to violate the act by usurping a franchisee's discretion to carry out its business. Once the commission begins an investigation, it will not only examine written documents, such as franchise agreements, but also consider the actual business conditions and, among other things, interview franchisees. Thus, franchisors should ensure that they:

- have an accurate understanding of the approach that their employees take in advising and supporting franchisees;
- establish internal rules for employees in order to ensure compliance with the act; and
- provide appropriate training to employees.

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Endnotes

(1) Public Notice 15/1982 was designated by the commission pursuant to Article 2 (9) of the Anti-monopoly Act.

(2) In practice, this provision worked to the franchisor's advantage, since in nearly all cases the franchisees wished to renew their franchise agreements.

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