Franchising - Japan

Non-compete clauses in franchising agreements - use and limitations

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March 23 2010

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Introduction

Franchisors usually include a non-compete clause in their franchise agreements which obliges the franchisee not to operate a business that is identical or similar to the franchisor's business, both during the term of the agreement and for a certain time thereafter. Such clauses are intended to prevent a franchisee from (i) misappropriating the trade secrets or know-how disclosed during the franchise agreement, or (ii) exploiting the customers or markets acquired through the franchise. However, non-compete clauses may be deemed an excessive restraint of rights, including the franchisee's freedom to choose its occupation and operate its business. As a result, they are not always regarded as valid or enforceable according to their terms.

Key case law

A Kobe District Court decision exemplifies the considerations in such cases.(1)The franchisee processed and sold takeaway lunches pursuant to a franchise agreement. A dispute arose as to the validity of the franchise agreement's non-compete clause after termination of the franchise agreement. The clause stated: "[The franchisee] shall not operate any business in the same category as the franchisor's business in the location where the franchisee operates its business under the agreement."

The court stated that a non-compete clause may infringe a franchisee's rights (depending on the extent to which such rights are restricted), and noted that it may be declared void for violating public policy under Article 90 of the Civil Act.(2)

The court concluded that the disputed clause did not infringe the franchisee's freedom to operate its business and was therefore not contrary to public policy. In reaching this conclusion, the court recognized the necessity of such a non-compete clause to the franchisor's business. It stated that (i) the geographical restriction was limited to the place where the franchisee operated its business under the franchise agreement, and (ii) the scope of business prohibited by the clause was limited to business activities falling within the same category as the franchisor's business.

Comment

In determining the validity of the non-compete clause, the court considered factors such as the geographical scope of the restrictions and the nature of the restricted business activities. The judgment is not binding precedent, but it is informative for franchisors seeking to include a non-compete clause in their franchise agreements.

Although the court did not consider the point, the validity of a non-compete clause following termination of a franchise agreement may be covered by the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade. A clause that contains unreasonable terms or prohibits competition for an unreasonably long period may be deemed an abuse of dominant position and therefore an 'unfair trade practice' within the meaning of the act. Such clauses are subject to administrative scrutiny and penalties from the Fair Trade Commission.

For further information on this topic please contact Kenichi Sadaka, Taisuke Yamamoto or Yujin Nakano at Anderson Mori & Tomotsune by telephone (+81 3 6888 1000), fax (+81 3 6888 6849) or email (kenichi.sadaka@amt-law.com, taisuke.yamamoto@amt-law.com or yujin.nakano@amt-law.com).

Endnotes

(1) District court judgment, July 20 1992.

(2) Article 90 states: "A juristic act with any purpose which is against public policy is void."

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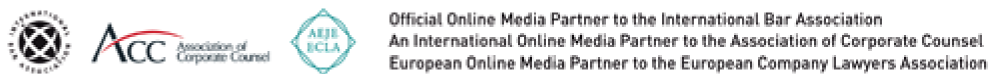

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