

Franchising - Japan

Telling it like it is: a franchisor's disclosure obligations

Contributed by [Anderson Mori & Tomotsune](#)

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When a franchisor considers entering the Japanese market, one of its primary concerns is whether disclosure obligations govern the proposed franchise in Japan. There is no franchise law that governs a franchisor's disclosure obligations in general. The need for such legislation is under discussion, but at present franchisors must determine whether individual laws govern the contemplated franchise. It is also necessary to consider court cases on disclosure obligations.

Statutory requirements

The first step is to check whether the disclosure obligations under the Medium and Small Retail Commerce Promotion Act (110/1973, as amended) apply to the proposed franchise. The purpose of the act is to promote the retail business of small and medium-sized companies. As such, it does not cover all franchises; rather, it affects only those relating to the conduct of retail business and those mainly targeting medium and small-scale franchisees.

The act defines a 'chain business' as a business that: (i) is principally targeted at medium-sized and small retailers; and (ii) utilizes a standard form agreement to engage in the ongoing sale of products or to act as an agent for sales of products and to provide guidance regarding the operation of the relevant business. The term 'specified chain business' is defined as a chain business which uses a uniform agreement whereby the franchisor (i) allows the franchisee to use trademarks, company names or other IP rights, and (ii) collects upfront fees, deposits or other fees from the franchisee when the latter joins the chain. The disclosure obligation under the act applies only when the contemplated franchise is a specified chain business.

The disclosure requirements under the act are relatively broad. They cover:

- upfront fees, deposits and other fees;
- the terms and conditions on which products are sold to the franchisee;
- details of management instructions;
- trademarks, company names and other IP rights that the franchisee may use; and
- the duration of the agreement and matters relating to renewal and termination of the franchise agreement.

In addition to the disclosure requirements under the act, the Guidelines Concerning the Franchise System under the Anti-monopoly Act also specify elements that, in the opinion of the Fair Trade Commission, it is desirable for a franchisor to disclose when approaching prospective franchisees. The guidelines define a 'franchise' generally as:

"a form of business in which the head office provides the member with the right to use a specific trademark and trade name, and provides coordinated control, guidance and support for the member's business and its management. The head office may provide support in relation to the selling of commodities and the provision of services. In return, the member pays the head office."

The definition under the guidelines is not limited to retail business franchises and is therefore broader than the definition under the act.

The guidelines merely state that it is desirable to disclose certain items; as such, failure to disclose does not automatically constitute a breach of the Anti-monopoly Act. However, when the commission considers a franchisor's alleged breach of the Anti-

monopoly Act, the issue of whether a franchisor has disclosed sufficient information is a significant consideration. Thus, even if the contemplated franchise agreement is not subject to a statutory disclosure obligation under the Medium and Small Retail Commerce Promotion Act, the franchisor must consider disclosing certain information pursuant to the guidelines - the information for which disclosure is deemed desirable is similar to that described in the act.

Court cases

It is also necessary to consider whether a franchisor has disclosed sufficient information to the potential franchisee in light of judicial precedents. In many cases the court has ruled that because of the information gap between the franchisor and the prospective franchisee, the franchisor owes a disclosure obligation under the principle of faith and trust even where no statutory obligation or express contractual obligation applies (ie, where the relationship is at a preparatory stage and the entities have not entered into a contract). Such an obligation may exist even where the franchisor discloses information pursuant to the Medium and Small Retail Commerce Promotion Act, but such information is insufficient for the franchisee to make an appropriate decision. Therefore, regardless of whether the franchisor owes a statutory or contractual disclosure obligation, it must consider whether the franchisee has sufficient information. If the franchisor is found to have breached the disclosure obligation, it is liable to compensate a franchisee for damages suffered. The scope of information to be disclosed depends on a number of factors, including the relationship between the parties, the experience of the prospective franchisee and the nature of the business.

In addition, information disclosed by the franchisor to a prospective franchisee may not be misleading and must be as precise as possible. One court has ruled that where a franchisor discloses information, such as sales forecasts, to a prospective franchisee at the preparatory stage, the principle of faith and trust requires that the franchisor conduct an adequate investigation to analyze the data appropriately and ensure that the information provided is as correct as possible.⁽¹⁾ The franchisor was found to have breached the obligation and was ordered to pay compensation for damages sustained by the franchisee, which had relied on the franchisor's sales forecast in entering into the franchise agreement, but had registered sales well below the projected figures.

Comment

Franchisors must carefully consider whether to disclose certain information and what kind of information to disclose. Disclosure is especially significant in light of the economic downturn and a corresponding rise in the number of lawsuits brought by franchisees against franchisors. Voluntary and proper disclosure of franchise-related information reduces the likelihood of disputes with franchisees and is advantageous for franchisors in defending lawsuits brought by franchisees.

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Endnotes

(1) Otsu District Court, February 5 2009.

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