



ICLG

The International Comparative Legal Guide to:

Franchise 2015

1st Edition

A practical cross-border insight into franchise law

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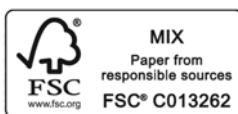
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Japan

Kenichi Sadaka



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Anderson Mori & Tomotsune

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory definition of the term “franchise” in Japan. Nevertheless, there are relevant definitions with regard to franchise businesses.

For instance, the Guidelines Concerning the Franchise System (Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947 – Antimonopoly Act) provide as follows:

“The franchise system is defined in many ways. However, the franchise system is generally considered to be 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 selling commodities and providing services. In return, the member pays the head office.”

1.2 What laws regulate the offer and sale of franchises?

The Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973 – MSRCPA) is the main piece of legislation. It primarily targets medium and small retailers and defines a “chain business” as a business that, pursuant to an agreement with uniform terms and conditions, continuously sells or acts as an agent to sell products and provide guidance regarding management. In addition, a “specified chain business” is defined as a chain business where the agreement includes clauses permitting its members to use certain trademarks, trade names or other signs, and collects joining fees, deposits or other money from the members when they become a member. If a certain franchise business falls under this definition, the MSRCPA applies. Since to be a “specified chain business” requires continuously selling or acting as an agent to sell products, the MSRCPA does not apply to a chain business unrelated to the sale of products. With respect to subsequent references to the MSRCPA, the relevant franchise business (including the relevant sub-franchise business) is assumed to fall within the scope of a “specified chain business”, unless otherwise stated.

Additionally, from the perspective of competition law, the Franchise Guidelines regulate the offer and sale of franchises in connection with the Antimonopoly Act. The Fair Trade Commission (FTC) has overall responsibility in this regard.

1.3 Are there any registration requirements relating to the franchise system?

No, there are no such requirements.

1.4 Are there mandatory pre-sale disclosure obligations?

Yes. When a franchisor intends to negotiate a franchise agreement with a prospective franchisee, the MSRCPA obliges the franchisor to provide written documentation to the prospective franchisee describing the prescribed items and explaining the contents of the written documents.

Specifically, the franchisor must disclose information concerning the following points to the franchisee:

1. the initial fee, security deposit or any other fee to be paid when the prospective franchisee becomes a franchisee;
2. the conditions of selling goods to a franchisee;
3. the assistance over operation of the franchisee;
4. the trademark, the trade name or any other signs to be licensed;
5. the term of the contract as well as its renewal and termination; and
6. other information, which is more specific, required by an Ordinance of the Ministry of Economy, Trade and Industry (METI).

1.5 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Whether pre-sale disclosure obligations apply to sales to sub-franchisees depends on the specific case. The relationship between the sub-franchisor and the sub-franchisee needs to be analysed; if it is considered to be a “specified chain business” under the MSRCPA, the sub-franchisor owes an obligation to disclose information relating to itself. The relationship between the franchisor and the sub-franchisor must also be analysed; if it too falls within the definition of a “specified chain business”, the franchisor is also under a disclosure obligation.

1.6 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The MSRCPA imposes an initial disclosure requirement. Prior to executing the franchise agreement, the franchisor must provide written

documentation to the prospective franchisee describing the prescribed items and explaining the contents of the written documents.

There are no laws or regulations regarding the frequency of updating disclosures or that impose an obligation to make continuing disclosure to existing franchisees.

1.7 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no other requirements in general, except for those provided in the MSRCPA and the Franchise Guidelines. However, if the franchise operates in an industry that is regulated by industry-specific laws, it is necessary to check the relevant laws and regulations.

1.8 Is membership of any national franchise association mandatory or commercially advisable?

The Japanese Franchise Association (JFA) is the leading national franchise association in Japan. Membership of the JFA is not mandatory under Japanese law. Whether or not it is commercially advisable to become a member of the JFA depends on the specific case. Further information and guidance in English is available on the JFA website: <http://www.jfa-fc.or.jp.e.ek.hp.transer.com/>.

1.9 Does membership of a national franchise association impose any additional obligations on franchisors?

Yes. The JFA has implemented voluntary rules, such as the Japan Franchise Association Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees. If a franchisor is a member of the JFA, these voluntary rules are an important consideration in the franchise relationship.

1.10 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no clear requirement for disclosure documents to be in Japanese. However, since the disclosure obligation is designed so that prospective franchisees have sufficient information and a good understanding of the franchise, it is strongly advisable to prepare disclosure documents in Japanese.

2 Business Organisations Through Which a Franchised Business can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in Japan?

Yes. The Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949 – FEFTA) is a key piece of Japanese legislation that provides general regulations for foreign transactions, including foreign direct investment in Japan. Under the FEFTA, certain foreign transactions involving “inward direct investment etc” by a foreign investor require a notification to the Japanese government. There are also various specific restrictions contained in industry-specific legislation, such as the Broadcast Act (Act No. 132 of 1950) and the Banking Act (Act No. 59 of 1981).

2.2 What forms of business entity are typically used by franchisors?

A joint-stock company stipulated in the Companies Act (Act No. 86 of 2005) is the most typical form of business entity used by franchisors.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in Japan?

The simplest means for a foreign company to establish a base for business operations in Japan is to set up a branch office. The branch office can begin business operations as soon as an office location is secured, the branch office representative is determined, and the necessary information is registered at a competent legal affairs bureau. Another way is to set up a foreign company’s subsidiary in the form of a joint-stock company, in which case the articles of incorporation and other incorporation documents need to be prepared and registered at a competent legal affairs bureau. If the franchise operates in an industry that is regulated by industry-specific laws, it is necessary to check the relevant laws and regulations.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

As stated in question 1.2, the Antimonopoly Act is relevant to the typical franchise agreement. The Franchise Guidelines and the Distribution Guidelines describe what kinds of activities or restrictions are problematic under the Antimonopoly Act.

The Franchise Guidelines require franchisors to disclose sufficient and accurate information in soliciting prospective franchisees, otherwise the franchisors’ actions can be deemed to be deceptive customer inducement which is illegal as it falls into one of the unfair trade practices.

If the restrictions on unfair trade practices under the Antimonopoly Act are violated, the FTC can order the breaching party to cease and desist from the activity, to delete the relevant clauses from the agreement and to take any other measures necessary to eliminate problematic activities (Antimonopoly Act, Article 20). Some of the categories, such as abuse of a dominant bargaining position and resale price restrictions, could be subject to surcharges (Antimonopoly Act, Article 20-5).

3.2 Is there a maximum permitted term for a franchise agreement?

No. There is no specific regulation.

However, as mentioned in question 13.1 below, if the term unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Act No. 89, 1896, Article 90).

3.3 Is there a maximum permitted term for any related product supply agreement?

No. There is no specific regulation.

However, as mentioned in question 13.1 below, if the term unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Article 90).

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

The Franchise Guidelines regulate transactions between franchisors and franchisees. According to these guidelines, it is acceptable for the franchisor to propose selling prices if it is necessary to provide a clear market position for the company or to coordinate business operations. However, when the franchisor supplies products to the franchisee, constraints on the selling price that apply to the franchisee could be a resale price constraint under the Antimonopoly Act. In addition, when the franchisor does not directly supply products to the franchisee, but unduly constrains the price of products or services supplied by the franchisee, this could constitute dealing on restrictive terms under the Antimonopoly Act.

3.5 Encroachment - are there any minimum obligations that a franchisor must observe when offering franchises in adjoining areas or streets?

Yes. The MSRCPA requires the franchisor to disclose information about other franchises in adjoining areas and streets to prospective franchisees. In addition, the Franchise Guidelines provide that it is desirable for the franchisor to properly disclose certain matters when inviting new franchisees to join the franchise. This avoids violating the Antimonopoly Act and enables prospective franchisees to make an informed decision. Specifically, the matters are those relating to restrictions that apply to the franchisor or other franchisees of the franchise in setting up a similar or identical business close to the proposed business of the party contemplating joining the franchise, including whether there are plans to set up additional businesses and the details of the plans.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Generally, yes. Franchisors usually include these sorts of covenants in their franchise agreements obliging 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 after expiration of the term. However, these covenants may be deemed as 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. In determining the validity of the covenant, the court considers factors such as the geographical scope of the restrictions, the terms of the covenant and the nature of the restricted business activities.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Franchisors can register trade marks with the Patent Office of Japan to protect them from being infringed. Even without this registration, the franchisors may take legal action under the Unfair Competition Prevention Act (Act No. 47 of 1993) if the trade marks in question are well-known.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

If the know-how, trade secrets and other business-critical information falls within the scope of a "trade secret" under the Unfair Competition Prevention Act, they will be protected against acts that constitute unfair competition. To be deemed a "trade secret", the information must fulfil three requirements: it must be useful; be unknown to the public; and have been controlled as a secret.

Confidentiality covenants between a franchisor and a franchisee are generally enforceable. If a franchisee breaches a confidentiality covenant, a franchisor may seek compensation for the damages caused by the violation or, in some cases, demand an injunction to prevent damages.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

If materials, including an Operations Manual or proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement, contain "creativity", then these materials can be protected by the Copyright Act (Act No. 48 of 1970).

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The METI and the relevant ministry which has authority to enforce the disclosure obligation under the MSRCPA may issue a recommendation to a franchisor who is not in compliance with the disclosure obligations (Paragraph 1, Article 12). If the recommendation is not followed, the minister may disclose this fact to the public (Paragraph 2, Article 12).

The MSRCPA does not provide a special remedy to franchisees when disclosure obligations are violated. Therefore, unless otherwise provided for in the franchise agreement, franchisees need to base any claims for damages on the general contract principles (Civil Code, Article 415) or general tort principles (Civil Code, Article 709). Franchisees can rescind the franchise agreement on the basis of fraudulent disclosure of information (Civil Code, Article 96). If there is a material misunderstanding about the franchise agreement, the franchisee can claim that the franchise agreement is void (Civil Code, Article 95).

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading allocated between franchisor and franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

A franchisor or a sub-franchisor owes disclosure obligations and will be responsible for breaching them. In the case of sub-franchising,

the sub-franchisor will usually be liable if there is a violation of a disclosure obligation because they are a party to the sub-franchise agreement and also the sub-franchisor directly provided the information to the sub-franchisee.

If a franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, the validity of the indemnification is assessed on a case-by-case basis. It may be deemed void if it is against good public policy (Civil Code, Article 90).

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement?

The validity of a disclaimer clause in the franchise agreement is assessed on a case-by-case basis. A disclaimer clause between business entities is usually deemed to be valid unless it is against good public policy (Civil Code, Article 90) or the good faith principle (Civil Code, Article 1), for example where one party breached the agreement intentionally or due to gross negligence.

5.4 Does the law permit class actions to be brought by a number of allegedly aggrieved claimants and, if so, are class action waiver clauses enforceable despite the expense and inconvenience of individual arbitrations?

Under Japanese laws currently in force, there is no system which is similar to a “class action” in the United States. In December 2013, the Act on Special Provisions of Civil Court Procedures for Collective Recovery of Property Damage of Consumers (Act No. 96 of 2013), which is to introduce a similar system in Japan, was enacted and promulgated and will take effect in a few years. However, franchisees will not be able to use the new system because it is applicable only to disputes arising from a consumer contract (i.e. a contract between a consumer and business operator) and a franchise agreement is not deemed as such.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No. Under Japanese international private law, the parties can usually select the governing law (the Act on General Rules for Application of Laws (Act No. 78 of 2006, Article 7) and therefore the franchise agreement is free to stipulate what law the parties have chosen. However, in some cases the choice of governing law can be invalidated or superseded, for example if a public order becomes an issue.

There is no generally accepted norm relating to the choice of governing law.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Generally, if a rogue franchisee is located in Japan then the franchisor can obtain an injunctive relief order from a Japanese court under the

Civil Preservation Act (Act No. 91 of 1989). However, injunctive relief orders issued by foreign courts, which are not final and binding foreign judgments, are unenforceable in Japan.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The length of term for commercial property leases (leases of buildings or houses) varies case by case, but they are usually two to five years. Moreover, under the Act on Land and Building Leases (Act No. 90 of 1991), the rights of lessees are highly protected and, in many cases, they have an option to renew the term.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Generally, it is possible for a franchisor and a franchisee to stipulate a clause in the franchise agreement relating to an option/conditional lease assignment in the lease agreement between the landlord and lessee (franchisee). Under Japanese law, however, transfer of the leasehold is subject to approval from the landlord. If approval is obtained in advance, then the transfer can go ahead (although the franchisor may have to solve the issue of evicting the franchisee from the premises). If the landlord does not approve, the franchisor may not, in principle, validly implement the transfer of the leasehold.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Generally, non-national entities can hold an interest in real estate and are able to sub-lease property.

Please note that the Act on Foreign Nationals' Rights in Relation to Land (Act No. 42 of 1925) provides that an ordinance can be enacted which restricts acquisition by foreign individuals or foreign companies due to considerations of reciprocity and national defence. However, no such ordinance is currently enacted.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease of a particular location)?

As of July 2014, demand for commercial offices has recovered in many cities and there is a solid forecast for the commercial real estate market.

Whether or not an initial rent free period is granted depends on the specific case. Usually, the lessee must pay a security deposit to the landlord and also pay some key money, which is non-refundable, to the landlord.

8 Online Trading

- 8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?**

Japanese law does not clearly prohibit the inclusion of this kind of requirement in the franchise agreement. However, passive restrictions on sales may be problematic depending on the situation.

The Franchise Guidelines provide that if the franchise agreement or action by the franchisor exceeds what is necessary to properly implement and operate the franchise business and caused some unfair disadvantage to the franchisee in light of ordinary business activities, then the franchise agreement and/or action by the franchisor may constitute an abuse of a dominant bargaining position.

- 8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?**

Generally, it is possible to require the former franchisee to transfer local domain names to the franchisor when the franchise agreement has expired or been terminated.

9 Termination

- 9.1 Are there any mandatory local laws that might override the termination rights that one might typically expect to see in a franchise agreement?**

Usually, the franchise agreement lists the circumstances in which the franchisor may terminate a franchise relationship. In addition, the franchisor may terminate if the franchisee violates the franchise agreement (Civil Code, Articles 541 to 543).

Nevertheless, because franchise agreements are usually continuous long-term agreements, courts are likely to be more reluctant to terminate them compared to non-continuous agreements. The doctrine of the destruction of a mutual trust relationship, which was established in the area of real estate lease agreements that are generally considered to be continuous agreements, is relevant here. With regard to lease agreements, a lessor's ability to terminate a lease agreement is limited to circumstances where the mutual trust relationship is destroyed because of the lessee's violation of the agreement (Supreme Court, 28 July 1964, 21 April 1966). This means that a lessor may not terminate a lease agreement even if the lessee is violating it, provided that the violation is not sufficiently material to destroy the mutual trust relationship. In many cases, this doctrine is applied or considered by the court to restrict a franchisor's ability to terminate a franchise relationship.

10 Labour Laws

- 10.1 Is there a risk that a franchisee or a franchisee's employees might be treated as the employees of the franchisor, so that the franchisor has vicarious liability for their acts and omissions? If so, can anything be done to mitigate this risk?**

In a typical franchise arrangement, a franchisee and its employees are not considered to be employees of the franchisor. To mitigate the risk that they might be regarded as such, a franchisor needs to structure the franchise relationship so that the franchisee is an independent entity, and needs to clearly explain the independent nature of the franchise relationship to the franchisee. In addition, if a franchisor is involved in hiring employees for the franchisee, it should explain its position and make it clear to the prospective employees that the employer will be the franchisee, not the franchisor.

A prefectural labour committee recently rendered a decision providing that the franchisee of a certain nationwide convenience store franchise chain falls within "worker" under the Labour Union Act. This decision effectively means that the franchisees can organise a labour union and negotiate with the franchisor as a labour union. Although the decision was not a court decision, future development of it should be monitored.

11 Currency Controls and Taxation

- 11.1 Are there any restrictions (for example exchange control restrictions) on the repatriation of royalties to an overseas franchisor?**

No. The repatriation of royalties to an overseas entity was liberalised pursuant to the FEFTA. However, there are some restrictions, for example the franchisee must comply with certain procedures depending on the amount of repatriation.

- 11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?**

Under the Income Tax Act (Act No. 33 of 1965), if royalties under a trade mark licence or consideration for the transfer of technology is paid to a non-resident individual or foreign entity which has no office place in Japan, the payment will be deemed as fees; if these fees fall within the domestic withholding tax requirements then they will be subject to withholding tax at a rate of 20%. Whether a payment is subject to a withholding tax requirement does not depend on its name or nominal term, but instead depends on whether the substance of the payment has the nature of a fee under the Income Tax Act. Additionally, if the tax rate stipulated in a tax treaty which Japan has signed is lower than that stipulated by domestic Japanese law (i.e. 20%), then the treaty will apply if certain procedures are complied with.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees and royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes. For instance, if it is deemed that the franchisee does not buy products from the franchisor but instead the franchisor consigns the sale of the products to the franchisee, then the franchisee is not a party to the transaction with the customer (the parties will be the franchisor and the customer). Therefore the franchisor will be directly liable as the seller against the purchaser of the product. In order to avoid this liability, the roles of the franchisor and franchisee should be clearly stipulated in the franchise agreement and it should be made clear to the customer that the transaction with him/her is with the franchisee.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly according to some objective test of fairness and reasonableness?

Under the Civil Code, there is a general duty to act in good faith (Article 1). In addition, if an agreement is unreasonably advantageous to one party, it may be deemed void for being against good public policy (Civil Code, Article 90). These clauses affect franchise relationships in various ways.

One area where the duty to act in good faith plays an important role is with regard to the franchisor's obligation to disclose information. Courts tend to construe this as an obligation to provide prospective franchisees with accurate and adequate information so that they can make decisions (Fukuoka High Court, 31 January 2006, *Shin Shin Do* case, Kyoto District Court, 1 October 1991).

Courts also tend to use Article 90 to limit or invalidate liquidated damages clauses. In the *Honke Kamadoya* case (Kobe District Court, 20 July 1992), the court stated that the clause providing for liquidated damages of an amount equal to 60 months' loyalty payment was significantly out of balance with the expected amount of damages. Consequently, the liquidated damages were declared void to the extent that they went beyond a reasonable amount of damages as such an amount was against good public policy.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No. The relationship should be regulated by ordinary contract law and the Antimonopoly Act, etc.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Although the MSRCPA does not clearly specify, if the term of the existing franchise agreement is just extended, the franchisor's disclosure obligations under the MSRCPA do not apply at the end of the franchise agreement term. On the other hand, if the existing franchise agreement is terminated and a new agreement with new terms and conditions is executed, the franchisor's disclosure obligations under the MSRCPA will apply prior to executing the new franchise agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

The franchise agreement generally states that a franchisor may refuse to renew it, or states, with the same implication, that the agreement will not be renewed unless it is mutually agreed. In some cases, the franchise agreement states that it will be automatically renewed unless either party notifies otherwise. The effect of the franchisor's contractual right to refuse to renew can be denied or limited in cases where, for example, the franchisee has been heavily dependent on the franchise business and the franchisor has no or few reasonable grounds to refuse renewal. In the *Hokka Hokka Tei* case (Nagoya District Court, 31 August 1998), the court required compelling circumstances which make it difficult to continue the agreement for a franchisor to be able to refuse to renew a continuous agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

As discussed in question 15.2, the franchisor's refusal to renew the franchise agreement is sometimes restricted. In these cases, if a franchisor unjustly refuses renewal they will usually be liable and must compensate for damage suffered by the franchisee.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes. If stipulated in the franchise agreement, a franchisor may effectively restrict a franchisee's ability to transfer its status or obligations under the franchise agreement. A franchise agreement usually requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. Generally, however, the franchisor cannot unreasonably refuse to give consent.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the former franchisee’s franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Including a “step-in” right in the franchise agreement is not clearly prohibited and there is no registration system. However, if the provision unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Article 90). In addition, the contractual relationships which the franchisee has had with other parties may not be transferred to the franchisor without the consent of each of the parties. Further, the government licences, permissions and approvals which the franchisee has owned in relation to the franchise business do not automatically go to the franchisor.



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16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the country and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Including this sort of clause in a franchise agreement is not clearly prohibited and there is no registration system. However, from a theoretical viewpoint, there may be issues regarding the validity of this sort of clause. Further, from a practical viewpoint, we do not believe that this sort of clause will work effectively. If the franchisee delegates powers relating to completion of a franchise migration to the franchisor by including a power of attorney in the franchise agreement, Japanese law provides for a “delegation relationship” or “quasi-delegation relationship”. This relationship is based on mutual trust between the parties and the franchisee can terminate the delegation at its own discretion and at any time. Even if the delegation of power involves a power of attorney in favour of the franchisor, it will be difficult for the franchisor to complete the necessary procedures if the franchisee objects.



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ANDERSON MŌRI & TOMOTSUNE

Anderson Mori & Tomotsune’s franchise practice team has in-depth knowledge of the laws and regulations pertaining to franchising. Our firm provides comprehensive and tailored legal services to clients with respect to structuring and operating a franchise system, including the preparation of relevant documents such as franchise agreements and disclosure documents. AM&T has considerable expertise in handling franchise litigation and alternative dispute resolution proceedings. Utilising our firm’s expertise in resolving franchise disputes, we also provide strategic advice to clients in order for them to avoid future disputes in any aspect of their franchise business.

Leveraging AM&T’s many years of experience and expertise in international transactions, we act for overseas clients seeking to expand into Japan through international franchising. Our support includes structuring, negotiating and drafting relevant documents such as international direct franchise agreements, international master franchise agreements and joint venture agreements. In addition, we support clients by actively providing advice on legal issues and regulations relevant to franchising in Japan.

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