International
Comparative
Legal Guides

Practical cross-border insights into franchise law

Franchise 2022

Eighth Edition

Contributing Editor:
Iain Bowler
Freeths LLP

bfa
ICLG.com

Industry Chapters

Q&A Chapters

Japan


Kenichi Sadaka


Aoi Inoue

Anderson Mōri & 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. 101 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 trade marks, 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 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a "franchisee" for purposes of any franchise disclosure or registration laws?

As stated in the response to question 1.2 above, the MSRCPA 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. Where a franchisor is planning to appoint only one franchisee in Japan, under current practice, such business is not regarded as a "chain business" and is not subject to disclosure obligations. This is because the relationship is not based on an agreement "with uniform terms and conditions".

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

No, there are no such requirements.

1.5 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 trade mark, 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), including the one stated in question 3.5 below.

1.6 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.

1.7 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.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

As mentioned in question 5.1 below, the Minister of Economy, Trade and Industry or the relevant minister who has the 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, such minister may disclose this fact to the public (Paragraph 2, Article 12).

1.9 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.

1.10 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.

1.11 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.

1.12 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 your jurisdiction?

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 your jurisdiction?

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 above, 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 the category of 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, Articles 20-5 and 20-6).

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 territories?

Yes. The MSRCPA and the ordinance of the METI require a franchisor to disclose information about the terms and conditions of the contract concerning whether a franchisor will engage in, or allow other franchisees to engage in, business operations conducting the same or similar retail business near the franchises of a franchisee. 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 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 in Japan.

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 fall 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; it must be unknown to the public; and it must 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", these materials can be protected by the Copyright Act (Act No. 48 of 1970).

5 Liability

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

The Minister of Economy, Trade and Industry or the relevant minister who has the 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, such 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). Also, if there is a material misunderstanding about the franchise agreement, the franchisee can rescind the franchise agreement (Civil Code, Article 95). Please note that an amendment to the Japanese Civil Code that substantively revised the provisions of the previous Civil Code took effect on 1 April 2020. The provisions cited in this Article are from the Civil Code after the amendment; however, the provisions prior to such amendment may apply to issues arising from agreements that were executed before 1 April 2020.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master 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 a disclaimer 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 local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The Act on Special Provisions of Civil Court Procedures for Collective Recovery of Property Damage of Consumers (Act No. 96 of 2013), which introduced a new Japanese class action system, came into effect on 1 October 2016. However, franchisees will not fall within the scope of 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 the law that 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 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 a preliminary injunctive relief order from a Japanese court under the Civil Provisional Remedies Act (Act No. 91 of 1989). However, preliminary injunctive relief orders issued by foreign courts, which are not final and binding foreign judgments, are unenforceable in Japan.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

In Japan, arbitration is generally recognised as a viable means of dispute resolution. Furthermore, businesses in Japan usually prefer arbitration to litigation in connection with international contracts. This preference is primarily motivated by their interest in ensuring the enforceability of the arbitral award and maintaining their privacy/confidentiality.

On 20 June 1961, Japan acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Convention, which took effect in Japan on 18 September 1961, ensures the enforceability in Japan of foreign arbitral awards issued in other signatory countries.

The Japan Commercial Arbitration Association (JCAA) is the most prominent arbitration institution in Japan (http://www.jcaa.or.jp/en/index.html). The JCAA has its own arbitration rules (JCAA Commercial Arbitration Rules), the latest amendments to which took effect on 1 July 2021. In addition to the JCAA, businesses often agree to arbitrate under the rules of major leading arbitral institutions including the ICC, LCIA, AAA/ICDR, SIAC and HKIAC.

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 optional/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 (Civil Code, Article 539-2). If approval is obtained in advance, 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 that 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. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant 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 in a flagship location)?

As of June 2021, demand for commercial offices has been levelling off in many cities, although it is necessary to continue to closely monitor the COVID-19 situation and its impact on 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 causes some unfair disadvantage to the franchisee in the light of ordinary business activities, 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 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 and 542).

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 for the house lease, 21 April 1966 for the land lease). 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.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Japanese law does not impose a minimum period for the notice that must be given to bring a franchise agreement to an end due to the expiration of the contract term. The notice period stipulated in the franchise agreement is typically sufficient. However, if a franchise agreement has been repeatedly renewed over the course of many years, the courts tend to deem such practice to constitute a continuous agreement (as discussed in question 9.1 above). In that case, according to court precedent, the notice period stipulated in the franchise agreement may not be sufficient. If a Japanese court does not find the notice period stipulated in the franchise agreement to be reasonable in light of the circumstances, the court may not permit the non-renewal of the franchise agreement. Alternatively, a Japanese court might issue a judgment finding the franchise agreement to have ended at the

expiration of the contract term, but award damages to the franchisee in consideration of its expectations of renewal.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

In a typical franchise arrangement, a franchisee's 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.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

As for vicarious liability, the Civil Code of Japan stipulates that "a person who employs others for a certain business shall be liable for damages inflicted on a third party by his/her employees with respect to the execution of that business" (Paragraph 1 of Article 715). In order to be deemed "a person who employs others for a certain business", a substantive instruction and supervision relationship is sufficient and a direct contractual relationship such as an employment agreement is not always required. For instance, there was a case where a main contractor was held to be vicariously liable for the act of the subcontractor's employee in the light of the instruction and supervision relationship between the two (Supreme Court, 12 February 1970). Therefore, whether a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees depends on whether or not a substantive instruction and supervision relationship between the franchisor and the franchisee's employees exists in addition to (or *in lieu* of) an instruction and supervision relationship between the franchisee and the franchisee's employees. This is evaluated on a case-by-case basis. To mitigate this risk, a franchisor should avoid creating a situation where a *de facto* substantive instruction and supervision relationship exists, such as the cases where the franchisor directly gives instructions to the franchisee's employees regarding specific tasks, where the franchisor is involved in hiring the franchisee's employees, where the franchisor virtually decides the amount of the salary of the franchisee's employees, and so on.

11 Currency Controls and Taxation

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

No. The payment of royalties to an overseas entity was liberalised pursuant to the FEFTA. However, there are some reporting requirements that the franchisee must comply with, depending on the amount of remittance from Japan to the foreign state.

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) and the relevant laws, if royalties under a trade mark licence or consideration for the transfer of technology are paid to a non-resident individual or foreign entity that has no office 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 20.42%. 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 that Japan has signed is lower than that stipulated by domestic Japanese law (i.e. 20.42%), 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 or 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 in its dealings with franchisees 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.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

As discussed in question 13.1 above, if a clause in the franchise agreement is unreasonably advantageous to one party, it may be deemed void for being against good public policy (Civil Code, Article 90). While the validity of a clause in the franchise agreement is assessed on a case-by-case basis, whether any limitation on a good faith obligation only applies from franchisee to franchisor (rather than being mutual) may affect the validity of such limitation.

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 above, 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 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 that the franchisee has had with other parties may not be transferred to the franchisor without the consent of each of the parties (Civil Code, Article 539-2). Further, the government licences, permissions and approvals that the franchisee has owned in relation to the franchise business do not automatically go to the franchisor.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all 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 jurisdiction 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.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Since Japanese law does not stipulate any specific requirements governing the conclusion of a franchise agreement, it is generally possible to validly enter into a franchise agreement through an electronic signature. Moreover, if an electronic signature satisfies the requirements of the Act on Electronic Signatures and Certification Business (Act No. 102 of 2000), the use of such electronic signature in any electromagnetic record creates the presumption that such record was established authentically. This presumption can make the validity and enforceability of the franchise agreement more certain. Currently, public key cryptosystems (e.g. the RSA method, ECDSA method and DSA method) have been adopted as a method to apply an electronic signature that satisfies the requirements under the said Act.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

If a franchise agreement is executed through electronic signatures, it can be stored electronically as long as it meets the requirements of the Act on Special Provisions concerning Preservation Methods for Books and Documents Related to National Tax Prepared by Means of Computers (Act No. 25 of 1998 – Electronic Books Preservation Act). In that case, it is unnecessary to prepare and store the paper version of the agreement.

By contrast, if a franchise agreement is executed through handwritten signatures, it can be scanned and saved as an electronic file as long as it meets the requirements of the Electronic Books Preservation Act. If those requirements are satisfied, the law does not require that the original paper version of the agreement be stored. However, it may be desirable to do so depending on the parties and the likelihood of a dispute. If a dispute arises, the original paper copy of the agreement can be produced during legal proceedings to prove the authenticity of the franchise agreement. From this perspective, caution should be exercised when determining whether to destroy the original paper version of the agreement.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Japan is considered to be a mature franchise market where franchising is common and has been used as a means for business growth. There are no limitations on the types of products or businesses that can use the franchising model. Furthermore, under Japanese law, a foreign franchisor can execute a franchise agreement with domestic franchisees without establishing a wholly owned subsidiary or a branch office in Japan and need not fulfil any registration requirement.

As stated in section 3, from the perspective of Japanese competition law, the Antimonopoly Act is relevant to a typical franchise agreement. Also, the Franchise Guidelines and the Distribution Guidelines describe what kind of activities or restrictions could be problematic under the Antimonopoly Act. Further, the FTC also expresses a keen interest in regulating franchise businesses and released an amendment of the Franchise Guidelines in April 2021. Under the amended Franchise Guidelines, for example, if a franchisor shares a sales model or revenue model (e.g. a simulation based on the average sales of existing franchisees) to a potential franchisee, the franchisor must explain to such potential franchisee explicitly that it is nothing more than a model and that it is not an expectation or a forecast. While the amendments to the Franchise Guidelines mainly envisage the convenience store industry, various other industries are also likely to be affected. Thoughtful franchisors take special care of complying with such laws and regulations including the Franchise Guidelines to avoid any disputes with franchisees or governmental authorities.

Kenichi Sadaka is a Partner at Anderson Mōri & Tomotsune, engaged mainly in international & domestic litigation, commercial arbitration and other alternative dispute resolution procedures.
Mr. Sadaka has represented many Japanese and foreign companies in disputes among management and/or shareholders, disputes related to insurance, franchise, cross-border transactions, financial products, product liability, debt collections, termination of distributorship agreements, intellectual property issues, real estate transactions, construction, labour, antimonopoly issues, mortgage enforcement, defamation, administrative remedies, and other matters.
In addition to these civil dispute activities, Mr. Sadaka has conducted internal investigations for several companies in relation to intra-company crimes and, based upon such scrutiny, exposed criminal accusations for embezzlement, fraud, and similar white-collar crimes.
Mr. Sadaka also provides day-to-day legal services for non-contentious legal affairs, such as advice on cross-border transactions (especially franchise contracts), doing businesses in Japan for foreign companies and doing businesses overseas (especially in Southeast Asian countries) for Japanese companies.

Anderson Mōri & Tomotsune
Otemachi Park Building
1-1-1 Otemachi, Chiyoda-ku
Tokyo 100-8136
Japan

Tel: +81 3 6775 1035
Email: kenichi.sadaka@amt-law.com
URL: www.amt-law.com

Aoi Inoue is a Partner and Co-head of international arbitration at Anderson Mōri & Tomotsune. He specialises in international arbitration and litigation. He represents clients in a wide range of business disputes, including joint ventures, distributorship, licensing, franchising, construction projects, complex financial products, labour and employment and product liability. He has acted as counsel in a number of international arbitrations under various rules, including the ICC, SIAC, HKIAC, JCAA and UNCITRAL. He has been recognised as a leading arbitration lawyer in *Who's Who Legal: Arbitration*, *The Legal 500: Asia Pacific*, *Best Lawyers* and *Benchmark Litigation Asia-Pacific*. He currently serves as Vice-Chair of the Dispute Resolution and Arbitration Committee of the Inter-Pacific Bar Association (IPBA).
Mr. Inoue also acts for overseas clients seeking to expand their business and operations into Japan through international franchising. He has been nominated for inclusion in the list of recognised franchise lawyers of *Who's Who Legal*.
Mr. Inoue received his LL.B. from the University of Tokyo, and holds an LL.M. from Columbia Law School. He is admitted to practise in Japan and New York.

Anderson Mōri & Tomotsune
Otemachi Park Building
1-1-1 Otemachi, Chiyoda-ku
Tokyo 100-8136
Japan

Tel: +81 3 6775 1122
Email: aoi.inoue@amt-law.com
URL: www.amt-law.com

Anderson Mōri & 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. AMT 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 AMT'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.

www.amt-law.com

ANDERSON MŌRI & TOMOTSUNE

ICLG.com

Current titles in the ICLG series

Alternative Investment Funds
Anti-Money Laundering
Aviation Finance & Leasing
Aviation Law
Business Crime
Cartels & Leniency
Class & Group Actions
Competition Litigation
Construction & Engineering Law
Consumer Protection
Copyright
Corporate Governance
Corporate Immigration
Corporate Investigations
Corporate Tax
Cybersecurity
Data Protection
Derivatives
Designs
Digital Business
Digital Health
Drug & Medical Device Litigation
Employment & Labour Law
Enforcement of Foreign Judgments
Environment & Climate Change Law
Environmental, Social & Governance Law
Family Law
Fintech
Foreign Direct Investment Regimes
Franchise
Gambling
Insurance & Reinsurance
International Arbitration
Investor-State Arbitration
Lending & Secured Finance
Litigation & Dispute Resolution
Merger Control
Mergers & Acquisitions
Mining Law
Oil & Gas Regulation
Patents
Pharmaceutical Advertising
Private Client
Private Equity
Product Liability
Project Finance
Public Investment Funds
Public Procurement
Real Estate
Renewable Energy
Restructuring & Insolvency
Sanctions
Securitisation
Shipping Law
Technology Sourcing
Telecoms, Media & Internet
Trade Marks
Vertical Agreements and Dominant Firms

The International Comparative Legal Guides are published by: global legal group