

PEOPLE'S REPUBLIC OF CHINA

On 31 December 2004 the Ministry of Commerce of the People's Republic of China promulgated the *Measures for the Regulation of Commercial Franchises*¹ which became the sole legal framework for franchising in China, replacing the *Circular of the Ministry of Domestic Trade Concerning the Promulgation of the Measures for the Administration of Franchise Operations (for Trial Implementation)* of 14 November 1997. The Measures became effective on 1 February 2005.

On 31 January 2007, the State Council adopted the *Commercial Franchise Administration Regulation*² which came into effect on 1 May that year. The Ministry of Commerce issued the *Administrative Rules on Commercial Franchise Filing* and the *Administrative Rules on Commercial Franchise – Information Disclosure*, which both came into force together with the Regulation on 1 May 2007. Subsequently the two were modified. The revised *Administrative Measures for the Record Filing of Commercial Franchises* and the *Measures for the Administration of Information Disclosure of Commercial Franchises* were implemented on 1 February 2012 and 1 April 2012 respectively.

The Regulations override the Measures in case of conflict between the two. Information on the possible repeal of these measures is awaited.

On 7 November 2011, the Inter-Departmental Meeting of the Ministry of Commerce adopted the *Commercial Franchise Registration Administrative Measures*. These Measures were promulgated by the Ministry of Commerce on 12 December 2011 as Decree No. 5. They came into force on 1 February 2012. Simultaneously, the *Commercial Franchise Registration Administrative Measures* (Ministry of Commerce 2007, Decree No. 15) was repealed. The *Commercial Franchise Information Disclosure Administrative Measures* (Ministry of Commerce, Decree No. 2), adopted at the 60th Inter-Departmental Meeting of the Ministry of Commerce on 18 January 2012, was promulgated on 23 February 2012 and entered into force on 1 April 2012. Simultaneously, the *Commercial Franchise Information Disclosure Administrative Measures* (Ministry of Commerce Order No. 16 [2007]), was repealed.

Measures for the Regulation of Commercial Franchises

The Measures provide a detailed regulation, comprising some 42 articles divided into nine Chapters.

Chapter I “General Provisions” (Articles 1 – 6) includes a definition of a commercial franchise as “an arrangement whereby a franchisor, through an agreement with a franchisee, grants the franchisee the right to use business operating resources including trademarks, trade names, business models. etc., which the franchisor has the right to grant others to use; and the franchisee shall operate under the uniform franchise system and pay franchise fees to the franchisor in accordance with the agreement” (Article 2). Article 4 specifies that a

¹ For an English translation of the Measures, see CCH, Business Franchise Guide, at ¶ 7065.

² State Council of the People's Republic of China, Ordinance No. 485, 31 January 2007.

franchisor is entitled to use master franchise arrangements, even if no more specific details are given.

Chapter II “Parties to Franchise Operations” (Articles 7 to 12) includes provisions on the qualifications of a franchisor (Article 7), the qualifications of a franchisee (Article 8), the rights of a franchisor (Article 9) and the obligations of a franchisor (Article 10), as well as on the rights of a franchisee and a franchisee’s obligations (Article 12). To be noted is that both franchisor and franchisee must be an enterprise or economic entity organised under the law of the country. The rights of a franchisor as specified in Article 9 include the rights to supervise the franchisee’s operations, to terminate the franchise agreement for breach of contract, infringement of the legitimate rights and interests of the franchisor or the damaging of the system, and to collect franchise fees, which are specified in Article 14. The obligations of the franchisor (Article 10) on the other hand include the duty to provide timely disclosure, to provide the operations manual and the signage necessary for the system, to provide training, and to supply the franchisee with goods. The franchisee may use other suppliers although the franchisor can fix quality standards. The rights of the franchisee (Article 11) include the right to use the intellectual property of the franchisor, to receive training, and to receive the goods supplied by the franchisor in a timely manner. The obligations of the franchisee (Article 12) include the obligation to conduct the business according to the agreement, to pay the required fees, not to transfer the franchise without the franchisor’s prior authorisation, to keep the franchisor’s trade secrets confidential, and to provide the franchisor with the information required under the Measures.

Chapter III “Franchise Agreement” (Articles 13 to 16). Article 13 specifies the information that is “generally included” in a franchise agreement, i.e. *inter alia* the names and addresses of the parties, the contents, term, location and exclusivity of the franchise, specifications as to the fees to be paid, details on the training and guidance offered, the use of the trade names, trademarks and other intellectual property, amendment and termination of the agreement, liability for breach, quality control and liability for the products sold or services offered. Article 15 states that the term of a franchise agreement shall be no less than three years and renewal can be negotiated. Article 16 specifies the obligations of the franchisee if the franchise agreement is terminated without the consent of the franchisor, such as not using the trade name of the franchisor any more.

Chapter IV “Information Disclosure” (Articles 17 to 22). Article 18 provides that a copy of the franchise agreement and a written disclosure document must be given to the prospective franchisee at least 20 days before the execution of the agreement. Article 19 further specifies the information that must be provided, including information on the registration of the intellectual property, on litigation that the franchisor was involved in over the five years prior to the conclusion of the agreement, information on the goods and services that the franchisor can supply the franchisee with, information on the principal officers of the franchisor, including whether they were personally responsible for the bankruptcy of any companies or have any criminal convictions. Article 20 provides for an obligation of the franchisee to disclose information to the franchisor on its legal status, credit history, etc. Articles 21 and 22 provide for a duty of confidentiality both in-term and post-term, as well as for prospective franchisees who do not sign the agreement.

Chapter V relates to Advertising (Articles 23 to 26).

Chapter VI "Oversight and Regulation" (Articles 27 to 31) Article 28 states that the franchise trade organisations shall adopt codes of ethics for the industry, Article 29 that every year the franchisor shall file a report with both the commerce regulatory authority of its locality and that of the franchisee's locality, and Article 30 that if the franchise involves a patent, a patent licensing agreement must be concluded and registered. Furthermore, prior to engaging in franchising operations the franchisor must register the trademark licensing agreement.

Chapter VII "Special Rules for Foreign Invested Enterprise" (Articles 32 to 37) In order to offer franchises in China, Foreign Invested Companies must apply for approval to the original approval authority and the requirements for such applications are stated in Article 33. Article 34 provides that a FIE which has received such an approval must file a report every January with both the original registration authority and the commerce regulatory authority of the franchisee's locality, disclosing information regarding the franchise agreements signed in the past year. Also FIEs already engaged in franchising have to follow this procedure.

Chapter VIII "Legal Liabilities" (Articles 38 to 40) Article 38 provides for fines in the case of a violation of Articles 7 and 8, Article 39 for non-disclosure, which also provides for the cancellation of the business licence in the case of serious violations, and Article 40 for the conducting of advertising and promotion in violation of the law.

Chapter IX "Supplemental Provisions" (Articles 41 to 42) Article 41 states that the Measures shall be interpreted by the Ministry of Commerce and Article 42 that the Measures shall enter into force on 1 February 2005, and replace the Interim Measures of the Regulation of Commercial Franchise Operations promulgated by the former Ministry of Domestic Trade.

Regulation on the Administration of Commercial Franchises (State Council Ordinance No. 485 of 31 January 2007)

The *Commercial Franchise Administration Regulation* has five chapters. Chapter I (Articles 1 – 6) contains "General Principles", while Chapter II (Articles 7 – 19) deals specifically with "Franchising Activities".

Article 8 of the Regulation provides for a registration requirement for franchises and lists the documents required for the registration:

"Article 8. Within 15 days after the execution of an initial franchise contract, a franchisor shall file with the competent commercial authority for recordal in accordance with the provisions of these Regulations. Where the franchisor engages in franchising activities within the territorial scope of a province, autonomous region, or municipality directly under the Central Government, it shall file with the competent commercial authority of the people's government of the concerned province, autonomous region, or municipality directly under the Central Government where it is located; and where the franchisor engages in franchising activities across the territorial scope of a province, autonomous region, or municipality directly under the Central Government, it shall file with the competent commercial authority of the State Council for recordal.

When filing with the competent commercial authority for recordal, a franchisor shall submit the following documents and materials:

- (1) A duplicate copy of its Business License or of its enterprise registration (filing) certificate;
- (2) A sample franchise contract;
- (3) Franchise operation manuals;
- (4) A marketing plan;
- (5) A written undertaking and relevant substantiating materials showing that the franchisor meets the requirements set forth in Article 7 hereof;
- (6) Other documents and materials as stipulated by the competent commercial authority of the State Council.

Where the products or services offered by the franchised business are subject to approval as required by law, the franchisor shall also submit the relevant approval documents.”³

Article 11 of the Regulation lists the items a franchise agreement should contain, including basic information on the franchisor and the franchisee; the types, amounts, and methods of payment of the franchise fees; the specific contents and methods of provision of guidance to the operation of the franchise, technical support, business training, and other services; quality and standards requirements, as well as guarantee measures, for the products or services offered by the franchised business; promotion and advertisement of the products or services offered; the arrangements for the protection of consumer rights/interests and the allocation of liability for compensation; amendments, rescission, and termination of the franchise agreement; liability for breach of the agreement; methods of dispute resolution; and other matters as agreed upon by the franchisor and the franchisee.⁴

The Regulation also provides for unilateral termination (Article 12), the minimum term of duration of the agreement (Article 13), the operating manual (Article 14), the quality and standard of the products and services (Article 15), specifications of the fees (Articles 16 and 17), the right of transfer of the franchise (none) (Article 18) and yearly reporting on the status of the agreement to the relevant commercial department (Article 19).

Chapter 3 of the Regulation (Articles 20 – 23) deals with the information to be disclosed, although it does not specify that it should be disclosed in a disclosure document, it speaks of “disclosure system” (see Article 20). Article 22 lists the items to be disclosed, which include franchise related lawsuits and arbitrated matters for the last five years and their status (Article 22(10)) and whether the franchisor or its management legal representative have been convicted of serious illegal operations (Article 22(11)).

Chapter 4 (Articles 24 – 30) deals with legal liability, and Chapter 5 (Articles 31 – 34) with supplementary articles, such as a provision on intellectual property (Article 31)

³ Translation provided by China Law Wiki at: http://www.chinalawwiki.com/index.php?title=Regulations_on_Administration_of_Commercial_Franchise. See also the Business Franchise Guide at ¶ 7070.

⁴ See China Law Wiki at: http://www.chinalawwiki.com/index.php?title=Regulations_on_Administration_of_Commercial_Franchise.

*Commercial Franchise Registration Administrative Measures (Ministry of Commerce 2011, Decree No. 5)*⁵

This Decree has 21 articles dealing specifically with the registration of the franchise. Article 6 specifies the documentation that the franchisor has to submit to the relevant registration authority. Article 12 specifies a number of instances in which the relevant Commerce Department may cancel the registration and publicly announce this. Article 15 specifies what information the general public has access to in the Business Franchise Information Management System.

Commercial Franchise Information Disclosure Administrative Measures (Ministry of Commerce 2012, Decree No. 2)

The *Commercial Franchise Information Disclosure Administrative Measures* have 12 articles dealing specifically with disclosure. Article 5 gives a list of the basic information the franchisor must provide the prospective franchisee with. Article 4 indicates that disclosure must be in writing. Article 6 deals with fraudulent advertising and promotion activities, Article 7 confidentiality agreements, Article 8 confidentiality agreements, and Article 9 misleading or concealed information.

⁵ See Business Franchise Guide at ¶ 7070.