

Franchising in China

June 2011

Franchise Regulations and Measures

Franchising in China has been regulated since 1997. But franchising by foreign franchisors was not expressly permitted until December 11, 2004, when the Measures for the Administration on Foreign Investment in Commercial Fields became effective.

The current franchising regulations, the Regulations on the Administration of Commercial Franchising, became effective May 1, 2007 (Franchise Regulations). The Measures on the Administration of Filing for Business Licensing (Registration Requirements) and the Measures on the Administration of Disclosure of Business Franchising Information (Disclosure Requirements) govern the registration of franchisors and disclosure requirements applicable to franchisees.

What Constitutes a "Franchise" and Franchisor Qualifications?

The Franchise Regulations broadly define a "franchise" as business activities under one or more contracts in which a franchisor allows a franchisee to use the franchisor's registered trademarks, business logos, patents, or other business resources, and the franchisee agrees to conduct business under the franchisor's uniform business format and to pay franchise fees.

The Franchise Regulations establish several qualifications for the franchisor. The franchisor must be an enterprise, own a well-developed business format, and be capable of providing necessary support (business guidance, technical support, and training) to the franchisee.

The franchisor must have at least two stores which it has owned and operated for more than one year. Prior to 2007, this so called "two + one" qualification, required the stores to be located in China. The 2007 change permitting the two + one qualification to be satisfied by stores located outside China has vastly simplified and shortened the time for entry by a foreign franchisor into the Chinese market.

Registration and Disclosure Requirements

The Registration Requirements require a franchisor to file specified documents with the Ministry of Commerce (or a provincial counterpart) within 15 days of signing its first franchise agreement. The filings are made through the MOFCOM website (www.mofcom.gov.cn). MOFCOM is required to register the franchisor within ten days of receiving all required documents.

The filing must contain information relating to the franchisor and its store locations, a marketing plan, the franchisor's business license, intellectual property rights, a sample franchise agreement, the franchise commercial prospectus, a catalogue of the franchising operational manual, any required governmental licenses or approvals applicable to the distribution of the franchised products or services, certificates evidencing satisfaction of the two + one qualification requirement, and other documents and information required by the Ministry of Commerce. Reports as to subscriptions of franchise agreements and alterations to the franchise agreement or the disclosure documentation must be submitted to the government on an annual basis. Alterations of the filed documentation must also be filed within 30 days.

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The Disclosure Requirements require franchisors to provide a sample franchise agreement with specified disclosure documentation at least 30 days prior to entering into a franchise agreement with a prospective franchisee. The disclosure standards require the information provided be accurate and complete and the regulations provide the franchisee a termination remedy for concealing related information or providing false information.

The required disclosures include information as to the franchisor (including domicile, registered capital, business scope), the registered trademarks, patents, know how and business model of the franchisor, the franchise fees, prices and requirements as to products, services and equipment to be provided to the franchisee, the business, guidance, technical support and training to be provided, the quality, distribution and business evaluation of existing franchisees in China, summaries of two years audited financial statements and other financial and accounting information, an investment budget for the franchised business, and involvement in litigation and arbitrations during the last five years.

A written franchise agreement is required. The Franchise Regulations specify the required items to be covered in the agreement including franchisor and franchisee information, the term of the agreement (generally at least three years), franchise fees, support services to be provided by the franchisor, product and service quality and other standards, modification and termination of the agreement, liabilities for breach, and dispute resolution. A "cooling off" period is also required but the period is not specified in the regulations.

IP Protections

Generally, trademark registration in China is a lengthy process. It is strongly recommended to register a trademark prior to the trademark owner entering the Chinese market.

Subject to specific exceptions, China follows a first to file rule, allowing the first person who files a trademark application the exclusive use of the mark within mainland China. China's Trademark Law, however, prohibits registration of a trademark that is considered identical or similar to a third party's well-known trademark that is not registered in China, provided that the use of such intended mark is similar to the use of the well-known trademark. It also prohibits registering a trademark that is considered identical or similar to a well-known trademark registered in China, even if it is intended to be registered under the different class.

Franchisors may also protect their intellectual property by copyright registration and design patent if applicable. Both copyright registration and design patents can protect trade dresses such as packaging, designs, visual appearance of a product, and even the design of a building or shop.

Trade secrets, such as know-how, are typically protected under Chinese laws, provided the franchisor takes reasonable steps to maintain confidentiality of the trade secrets including, for example, using protective non-disclosure agreements with parties having access to the trade secrets.

Contact us if you'd like assistance with your international franchising initiatives. We can discuss the challenges, identify the obstacles, and lead you to solutions for expanding your franchise internationally.

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