



Newsletter of the INTERNATIONAL COMMERCIAL TRANSACTIONS, FRANCHISING AND DISTRIBUTION COMMITTEE

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RECENT DEVELOPMENTS IN SOUTH KOREAN FRANCHISE LAWS

By Philippe Shin, Byung-Tae Kim & Hyunju Lee

Major Provisions of Fair Transactions in Franchise Business Act

On July 2, 2013, the National Assembly passed a partial amendment (the “Amendment”) to the “Act on Fair Transactions in Franchise Business”(the “Franchise Act”). The Amendment will become effective six months after its proclamation (expected in February 2014).The major purposes of the Amendment are: (i) to strengthen the rights of franchisees; (ii) to remedy unfair practices of franchisors; and (iii) to strengthen the obligation to provide information. The key aspects of the Amendment are detailed below.

Extended Prohibition of Unfair Transactions by Franchisor

- *Prohibition of imposition of store environment improvement on franchisees and obligation of cost sharing (Article 12-2):* The Amendment added a new provision prohibiting a franchisor from imposing store environment improvement on its franchisees without justifiable reasons. Under the new provision, a franchisee will bear the cost of store environment improvement at a rate determined by Presidential Decree, to the extent such rate is less than 40%; *provided, however*, that if a franchisee has to improve its store environment due to sanitation or safety concerns resulting from works voluntarily performed by the franchisee or otherwise attributable to the franchisee, without the franchisor’s request, the franchisor is not required to bear the cost.
- *Prohibition of restriction of business hours (Article 12-3):* The Amendment prohibits the practice by certain franchisors of unfairly restricting the franchisee’s business hours. Thus, it shall be deemed as unfair restriction of business hours if the franchisor does not permit a franchisee to reduce its business hours, (i) even though such franchisee has suffered losses due to its operation during night hours, as the relevant sales are lower than the cost, or (ii) even though such franchisee requests a reduction in business hours due to unavoidable circumstances, such as disease or treatment of disease.
- *Protection of business area (Article 12-4):* Before the Amendment, there was no provision requiring the franchisor to define a business area. The amended

Franchise Act now provides that, when executing an agreement, the franchisor is obligated to define and stipulate the business area for a franchisee in the agreement. Further, the franchisor is not permitted to set up another franchisee or any shop of the same trade or otherwise directly operated by the franchisor in the same business area without justifiable reasons; *provided, however*, that in the event of any cause stipulated by Presidential Decree, the business area may be reasonably adjusted through consultation between the franchisor and the franchisee at the time the relevant franchise agreement is renewed. This new provision is scheduled to become effective one (1) year after the proclamation of the Amendment as its implementation must in practice be preceded by a grace period to adapt to the new requirements.

Increase in Franchisor’s Obligation to Provide Information

The Amendment contains new provisions that require franchisors to provide written materials on estimated sales. Under the pre-amendment Franchise Act, franchisors are required to allow franchisees or potential franchisees to access information related to sales forecast only at their request. Under the Amendment, however, all franchisors over a certain size (determined by Presidential Decree) shall provide potential franchisees with the scope of estimated sales and the relevant calculation grounds at the time of execution of a franchise agreement, and shall maintain such information for five (5) years from the date of execution of the franchise agreement (Article 9(5)).

In addition, the Amendment requires franchisors to provide disclosure documents by content-certified mail or other means prescribed by Presidential Decree, from which the date of provision of information can be identified. The Amendment strengthens the overall disclosure obligations by (i) requiring franchisors to specify whether they have violated the “Act on General Terms and Conditions” and information on franchisor’s assistance for the management and sale activities of franchisees in disclosure documents, and (ii) increasing the amount of the fine in case of provision of false or exaggerated information (Article 7).

Measure to Strengthen Protection of Franchisee's Rights and Negotiation Leverage

The Amendment permits franchisees to form an organization (similar to a trade union) to protect their rights and advance their economic status. The Amendment grants a franchisee organization, composed of franchisees with the same trade dress, the right to request consultation on transaction terms, including modification of a franchise agreement, with the franchisor, while obligating the franchisor to accept such request. Meanwhile, under the Amendment, the franchisor shall not penalize franchisees on the grounds that they have formed, have been admitted to, or have been involved in the activity of a franchisee organization. In the event of violation of the foregoing, the franchisor may be subject to corrective measures or a fine (Articles 14-2, 33 and 35).

Other Provisions – Repeal of Exclusive Right of Complaint

Under the pre-amendment Franchise Act, certain criminal violations of the Franchise Act could be prosecuted only when the Korea Fair Trade Commission (“KFTC”) had filed a complaint, and the Prosecutor General had the exclusive right to request the KFTC to file such complaint. The Amendment, however, grants such right to the Chairman of the “Board of Audit and Inspection” (a governmental watchdog) and to the head of the “Small and

Medium Business Administration” (a quasi-governmental body in charge of promoting SMEs). When so requested, the KFTC is required to file a criminal complaint (Article 44).

Recently, the sudden increase in the number of franchise brands and franchisors has meant a corresponding increase in the number of disputes involving franchisees and domestic franchisors. In those disputes, franchisees, often small businesses and individuals, are prone to suffer unfair consequences. This situation has affected Korean society to such a point that lawmakers have decided to revise the Franchise Act as summarized above in an effort to protect franchisees from franchisors’ unilateral and unfair transaction practices.

Operating a franchise in Korea requires the understanding of the circumstances which led to the revision of the Franchise Act and the reinforcement of the franchisee’s protection in the Amendment. Further, one will need to review existing franchise agreements and the relationship with franchisees based on the terms of the Amendment, to ensure that one will remain in compliance with the Franchise Act. However, until the Presidential Decree specifying the details of the enforcement of the Amendment, a number of questions will remain unanswered.

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