

Franchising in Chine

CHINESE FRANCHISING NEW LAW N°485 Dated February 6, 2007

A new set of rules concerning Franchising has come into effect as of May 1st.

I. HISTORICAL BACKGROUND

The necessity to regulate franchising appeared in China simultaneously with that to regulate foreign investments. In 1997 existed a purely Chinese franchising law, applying exclusively to Chinese networks. Hence, foreign networks started developing on purely sui generis contractual grounds. In practical terms, the usual pattern was for the licensing of a trademark to a Chinese entrepreneur.

Government had to recognize incomplete legislation and submitted foreign companies to a special statute when developing in China. Therefore, creation of a company with foreign assets was submitted as of 2004 to a very formal prior authorization procedure. Further, these companies could only be joint-ventures. The gap to a franchise rule is until such date very wide, the government's main goal being to control foreign capital investments in Chinese economy.

In 2005, the first franchising law is enacted : In compliance with this law, foreign networks could not invest on the Chinese market from abroad. A Franchisor first had to create a Chinese company with foreign or mixed assets. Regulations on foreign investment had therefore to be applied on top of regulation on franchising, with a procedure of double authorization, both at a local and government level.

Moreover, Franchisor had to open to outlets under his Trade Sign and operate them for a two year term before being authorized to « sell » the concept to a Chinese entrepreneur. Everything was organized so the Franchisor had to start from scratch.

II. LAW N°485 dated February 6, 2007

The new law sets out several new guidelines :

Rule n°1: franchisor must provide evidence of his past experience, by the existence of at least two outlets operating the concept under his Trade Sign and having operated them for at least one year. These conditions appear more relaxed since they do not impose any more evidence that franchisor has operated from Chinese soil.

Rule n°2: within 15 days of signing the first franchise contract, franchisor must inform of its existence with the local authority who shall then register the new file within 10 days and transmit the file to government authority in view of transcription on the national franchisors list. Franchisor must declare every year all new franchisees. The procedure, which previously required approval from administration, is now a declarative procedure.

Rule n°3: franchisor must hand over to prospective franchisee a disclosure document very similar to the French Law Doubin disclosure document. The rule provides prospective franchisee a 30-day reflection period.

Rule n°4: the signing of the contract triggers in favor of franchisee a retraction delay. Usual provisions of the contract under the law comply with the usual international contractual rules and are subject to negotiation

between parties.

Rule n°5: the franchising law includes fines in case of violation.

III. CONCLUSION

Franchising in China is becoming more elaborate and liberal. Yet, it still remains under the omen of bureaucracy and criminal law, with the aim of exercising a control and regulation over foreign investment in China.

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