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Ohio Northern University Law Review

Lead Articles

How Does Chinese Law Regulate Franchising?

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China is the world's second-largest economy,¹ encompassing a large portion of the world's franchise market with 2,600 brands and 200,000 retail stores across nearly eighty industrial sectors.² Two of the main franchising sectors in China are retail stores and catering.³ The number of consumers shopping at franchises has reached 600,000,000 by 2015 from middle-tier consumers alone.⁴ In China, as in other civil law countries, the hierarchy of legal rules begins with laws or codes that set forth the general rules applicable

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1. *Explore All Countries China East and Southeast Asia*, CIA.GOV: CHINA-THE WORLD FACTBOOK, (July 25, 2003), <https://www.cia.gov/the-world-factbook/countries/china/#economy>.

2. The JIJ Group, *CHINA: Franchising Industry Access Dynamic and Emerging Markets*, U.S. COM. SERV. U.S. DEP'T OF COM. 1, 23 (2012) <https://www.yumpu.com/en/document/view/2381146/china-franchising-industry-exportgov>; See Philip F. Zeidman, *China: 2010 and Beyond*, INT'L FRANCHISE ASS'N (Jan. 2010), <HTTP://WWW.FRANCHISE.ORG/CHINA-2010-AND-BEYOND> [<HTTPS://WEB.ARCHIVE.ORG/WEB/20150411072428/>] (stating that at least fifty American franchisors have entered the Chinese market. Examples include 7-Eleven, Accor, Athlete's Foot, Budget, Burger King, California Pizza Kitchen, Carl's Jr., Century 21, Dairy Queen, Days Inn, Dunkin' Donuts, Econo Lodge, Gloria Jean's Coffee, Haagen Dazs, Hilton, Holiday Inn, Hooters. Other examples include Hyatt, KFC, Marriott, McDonald's, Papa John's, Pizza Hut, Sign-A-Rama, Starbucks, Starwood, Subway, Super 8, T.G.I. Friday's, Taco Bell, TCBY, and Wyndham).

3. *Research and Markets: China Franchise Market Report, 2010*, BUSINESS WIRE (Feb. 4, 2011), available at <http://search.proquest.com/docview/849231047?accountid=8285>.

4. See generally *Id.*

to different aspects of legal transactions, followed by guiding and explanatory regulations, decrees, orders, and ordinances.⁵

The first Chinese law to address franchising specifically was the Measures for the Administration of Commercial Franchise Operations.⁶ These Measures were replaced with the Measures for the Administration of Commercial Franchises, referred to as the “Old Measures.”⁷ The Regulations on Administration of Commercial Franchise or the “Chinese New Regulations” then replaced the Old Measures in 2007.⁸ The Chinese Ministry of Commerce (“MOFCOM”)⁹ issued two sets of rules implementing and interpreting the Chinese New Regulations: The Administrative Measures for Archiving Commercial Franchises (“Archiving Measures”)¹⁰ and the Measures for the Administration of Information Disclosure of Commercial Franchises (“Chinese Disclosure Measures”).¹¹ Other measures and notices related to the Chinese New Regulations and their implementing rules have been issued by administrative agencies.¹²

5. Paul Jones & Erik Wulff, *Franchise Regulation in China: Law, Regulations, and Guidelines*, 27 *FRANCHISE L.J.* 57, 57 (2007).

6. The Measures for the Administration of Commercial Franchise Operations were issued by the Ministry of Internal Trade in 1997. See ILAN ALON & DIANNE H.B. WELSH, *INTERNATIONAL FRANCHISING IN EMERGING MARKETS CHINA, INDIA, AND OTHER ASIAN COUNTRIES*, 85 (John W. Arden & William S. Zale eds., 2001); See generally Bryan W. Blades, *Franchising in China: A Current Perspective*, 14 *CURRENTS: INT'L TRADE L.J.* 20, 22-23 (2005).

7. Dr. Michael Liu, *Franchise Registration for International Franchisors in China*, HG.ORG LEGAL RESOURCES, <https://www.hg.org/legal-articles/franchise-registration-for-international-franchisors-in-china-5791> (last visited Aug. 30, 2023); See generally Measures for the Administration of Commercial Franchises (promulgated by the Ministry of Com., Dec. 30, 2004, effective Feb. 1, 2005) CLI.4.56488(EN), [http://www.lawinfochina.com/display.aspx?id=3887&lib=law&SearchKeyword=commercial%20franchises&SearchCKeyword=\(Lawinfochina\)](http://www.lawinfochina.com/display.aspx?id=3887&lib=law&SearchKeyword=commercial%20franchises&SearchCKeyword=(Lawinfochina)).

8. *Id.* See also ELIZABETH CRAWFORD SPENCER, *THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY* 227 (2010); See generally Regulations on the Administration of Commercial Franchises (promulgated by State Council, Jan. 31, 2007, effective May 1, 2007), CLI.2.88185(EN), [http://www.lawinfochina.com/display.aspx?id=5873&lib=law&SearchKeyword=commercial%20franchises&SearchCKeyword=\(Lawinfochina\)](http://www.lawinfochina.com/display.aspx?id=5873&lib=law&SearchKeyword=commercial%20franchises&SearchCKeyword=(Lawinfochina)).

9. See generally MINISTRY OF COMMERCE PEOPLE'S REPUBLIC OF CHINA: MISSION, <http://english.mofcom.gov.cn/column/mission.shtml> (last visited Aug. 3, 2023).

10. See generally Regulation on Administrative Measures for Archiving Commercial Franchises (deliberated and adopted at the sixth executive meeting of Ministry of Com. on April 6, 2007, effective May 1, 2007) [http://www.asianlii.org/cn/legis/cen/laws/amfacf535/\(China\)](http://www.asianlii.org/cn/legis/cen/laws/amfacf535/(China)) [hereinafter Chinese Archiving Measures]; SPENCER, *supra* note 8, at 181.

11. See generally Regulations on Measures for the Administration of Information Disclosure of Commercial Franchises (discussed and adopted at the 6th executive meeting of the Ministry of Com. on April 6, 2007, effective May 1, 2007) [http://www.asianlii.org/cn/legis/cen/laws/mftaidocf761/\(China\)](http://www.asianlii.org/cn/legis/cen/laws/mftaidocf761/(China)) [hereinafter Chinese Measures for the Administration of Information Disclosure]. See also SPENCER, *supra* note 8, at 181.

12. See generally Notice of the State Administration of Foreign Exchange on the Pilot Work of Franchise Individual Foreign Exchange Business (promulgated by the State Admin. of Foreign Exchange, effective Aug. 19, 2008), CLI.4.117934 (EN) <http://www.lawinfochina.com/display.aspx?id=7747&lib=law> (Lawinfochina). See also Regulations on Measures for the Pilot Work of Franchised Individual Foreign Exchange Business (promulgated in by the State Admin. of Foreign Exchange, Nov. 9, 2009, effective Nov. 9, 2009), CLI.4.123271(EN) <http://www.lawinfochina.com/display.aspx?id=8242&lib=>

In addition to the franchise regulations and measures already mentioned, franchise agreements in China are usually subject to the general rules of certain bodies of law, such as Contract Law.¹³ Consideration should also be given to Company Law¹⁴ and Arbitration Law.¹⁵ Moreover, the Chinese intellectual property laws are closely connected to franchising and consist of Copyright Law,¹⁶ Law on Unfair Competition,¹⁷ Patent Law,¹⁸ Trademark Law,¹⁹ and Anti-Monopoly Law.²⁰

I. UNDERSTANDING THE CONCEPT OF FRANCHISING IN CHINA:

The Chinese New Regulations address the basic elements of franchising, including intellectual property, business plans, and fees.²¹ The Regulations'

law (Lawinfochina); Notice of the Higher People's Court of Beijing Municipality on Issuing the Guiding Opinions of the Higher People's Court of Beijing Municipality on Several Issues Concerning the Application of Law in the Trial of Disputes over Commercial Franchise Contracts (promulgated by Judicial Comm. of the Higher People's Court of Beijing Municipality, Feb. 14, 2011, effective, Feb. 24, 2011), CLI.13.479015(EN)(LFC), <http://www.lawinfochina.com/display.aspx?id=8597&lib=law> (Lawinfochina).

13. *See generally* Regulation on the Contract Law of the People's Republic of China (promulgated by the Nat'l People's Cong. Mar. 15, 1999, effective Oct. 1, 1999), CLI.1.21651(EN), <http://www.lawinfochina.com/display.aspx?id=6145&lib=law&SearchKeyword=contract%20law&SearchCKeyword=> (Lawinfochina) [hereinafter Chinese Contract Law].

14. *See generally* Regulations on Company Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994) CLI.17672(EN), <http://www.lawinfochina.com/display.aspx?id=641&lib=law&SearchKeyword=Company%20Law&SearchCKeyword=> (Lawinfochina).

15. *See generally* Arbitration Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug. 31, 1994, effective Sept. 1, 1995), <https://lawinfochina.com/display.aspx?id=710&lib=law&SearchKeyword=arbitration%20law&SearchCKeyword=> (Lawinfochina).

16. *See generally* Copyright Law (promulgated by the Standing Comm. of the Nat'l People's Cong., Sept. 7, 1990, effective June. 1, 1991), <https://lawinfochina.com/display.aspx?id=1211&lib=law&SearchKeyword=copyright%20law&SearchCKeyword=> (Lawinfochina).

17. *See generally* Regulation on Anti-unfair Competition Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993), <https://lawinfochina.com/display.aspx?id=30402&lib=law&SearchKeyword=unfair%20competition&SearchCKeyword=> (Lawinfochina) [hereinafter Chinese Unfair Competition Law].

18. *See generally* Patent Law of the People's Republic of China (2008 Amendment) (promulgated by the Standing Comm. of the Nat'l People's Cong., Mar. 12, 1984, effective Oct. 1, 2009), <https://lawinfochina.com/display.aspx?id=7289&lib=law&SearchKeyword=patent%20law&SearchCKeyword=> (Lawinfochina).

19. *See generally* Trademark Law of the People's Republic of China (2001 Amendment) (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug. 23, 1982, amendments effective Dec. 1, 2001), CLI.1.37085(EN), <http://www.lawinfochina.com/display.aspx?id=2107&lib=law&SearchKeyword=trademark%20%20law&SearchCKeyword=> (Lawinfochina) [hereinafter Chinese Trademark Law].

20. *See generally* Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), CLI.1.96789(EN), <http://www.lawinfochina.com/display.aspx?id=6351&lib=law&SearchKeyword=monopoly%20law&SearchCKeyword=> (Lawinfochina) [hereinafter Chinese Anti-Monopoly Law].

21. Regulations on Administering Commercial Franchises (promulgated by State Council, Jan. 31, 2007, effective May 1, 2007), art 3, <http://www.asianlii.org/cgi-bin/disp.pl/cn/legis/cen/laws/roac460/>

definition of franchising, however, is sometimes criticized for being neither precise nor accurate, as it may extend to include other types of businesses that are only similar to franchising.²² Additionally, the Regulations restrict franchising to enterprises.²³ An enterprise is any business, including a company, partnership, joint-stock cooperative, state-owned business, collectively-owned business, joint venture, wholly foreign-owned enterprise, or foreign-invested joint stock limited company.²⁴ Limiting franchising to enterprises means that individual projects are not allowed to be franchisors in China.²⁵ If the enterprise requirement is violated, Article 24 of the Chinese New Regulations provides for a penalty fine.²⁶

The Chinese New Regulations requires a franchisor to have a business model and to provide his franchisees with any required guidance, training, technical help, or other similar assistance.²⁷ That mechanism meets the control and assistance as an essential element required to have a franchise.²⁸ Control and assistance is the extent to which franchisors manage and direct different aspects of the franchised business.²⁹ In essence, control takes place through various activities such as assisting franchisees in choosing a location, preparing the premises, and fulfilling the requirements for design and appearance.³⁰ Control also includes assisting to a certain extent with business operations, providing technical training for the franchisee's employees, and providing help with establishing accounting systems and marketing.³¹ The importance of control and assistance is that it ensures that franchisors maintain the goodwill of their businesses and protect use of their franchised trademarks.³²

The Chinese New Regulations also connect franchise transactions with marketing plans by requiring franchisees to conduct the franchised business in accordance with the business model determined by the franchisor.³³ A

roacf460.html?stem=0&synonyms=0&query=title(Regulations%20on%20Administering%20Commercial%20Franchise (Asianlii.org) (China) (hereinafter Chinese New Regulations).

22. Jones & Wulff, *supra* note 5, at 58.

23. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, INTERNATIONAL FRANCHISING 96 (Dennis Campbell & Antonida Netzer eds., 2008).

24. Yanling Ren, *China*, GETTING THE DEAL THROUGH FRANCHISE 28 (Philip F. Zeidman ed., 2011), https://web.archive.org/web/20130828201137/http://www.franchise.org/uploadedFiles/Franchise_Industry/F2011Chinachapter.pdf.

25. *Id.*

26. Chinese New Regulations, *supra* note 21, at art. 24.

27. Chinese New Regulations, *supra* note 21, at art. 7.

28. Mark H. Miller, *Unintentional Franchising*, 36 St. Mary's L.J. 301, 315, 343-44 (2005) (stating in the United States, for example, both the FTC Rules and state laws regulate business opportunities).

29. *Id.*

30. *Id.* at 343-45.

31. *Id.* at 309.

32. *Id.* at 320-21.

33. Chinese New Regulations, *supra* note 21, at art. 3.

marketing plan outlines a method for operating the business according to the system determined by the franchisor.³⁴ “It usually requires use of the franchisor’s trademarks, business standards, product and service specifications, training systems, operation manuals, specific advertising systems, and other requirements determined by the franchisor to establish a consistent look across all the franchised outlets.”³⁵ The Chinese New Regulations seeks to avoid making the marketing plan optional to confirm the importance of the plan as one of the core elements of franchising.³⁶ It would also enhance the franchisor’s ability to supervise a franchisee’s conduct and could affect the franchisor’s goodwill.³⁷

Though the Chinese New Regulations is silent about a community of interests as a pillar for franchising, the New Regulations provide that the payment of franchising fees is an element of a franchise.³⁸ The New Regulations require inclusion in the franchise agreement information of the type, amount, and payment method of franchising fees.³⁹ A community of interests exists where the shared financial interests in the success of the business, particularly when each of the parties is dependent on the other to some extent.⁴⁰ One can conclude that requiring a mutual financial interest guarantees a certain degree of seriousness of the contracting parties.⁴¹

Finally, licensing the use of a trademark is the core of a franchise transaction in China, as well as the rest of the world.⁴² In China, registration of a trademark is mandatory under Article 4 of the Chinese Trademark Law which requires trademarks to be registered with the State Trademark Office (“STO”).⁴³ The Chinese Trademark Law further provides a list of signs that cannot be registered as trademarks.⁴⁴ The duration of a registered trademark, under the Chinese trademark laws is ten years, but, just like in the U.S., is renewable.⁴⁵ In addition, if the trademark owner decides to assign ownership of the trademark, both the assignor and assignee must conclude an assignment

34. KERRY L. BUNDY & ROBERT M. EINHORN, *FUNDAMENTALS OF FRANCHISING* 191-92 (Rupert M. Barkoff et al. eds., 4th ed. 2015); *See, e.g.*, Cal. Corp. Code § 31005 (2012); Conn. Gen. Stat. § 42-133e (2012).

35. Radwa S. Elsaman, *Franchising in the Middle East: The Example of Egypt*, 35 *Pacific Basin L.J.* 39, 43 (citing Rochelle B. Spandorf, *Franchise Player*, 29 *LOS ANGELES LAW* 34 (2006)).

36. *See generally* Chinese New Regulations, *supra* note 21.

37. *Id.* at art 22.

38. *Id.* at art. 3.

39. *Id.* at art. 11.

40. BUNDY & EINHORN, *supra* note 34, at 192-93.

41. *Id.* at 192.

42. *See generally* Chinese Trademark Law, *supra* note 19.

43. *Id.* at art. 4.

44. *Id.* at arts. 10-11.

45. *Id.* at arts. 37-38; Malaysian Trademark Act 1967, at arts. 32, 41, 42 (*Warta Kerajaan seri Paduka Baginda Gazette*, 24 June 1976), available at http://www.commonlii.org/my/legis/consol_act/tma1976121/.

agreement and submit a joint application to the STO.⁴⁶ The assignee may then enjoy the exclusive right to use the trademark from the date of publication.⁴⁷ Chinese Trademark Law also provides licensors more rights than licensees.⁴⁸ For instance, the Law explicitly provides for the licensor's right to supervise the quality of the goods for which the licensee uses the trademark and requires the licensee to guarantee the quality of the goods.⁴⁹

Moreover, Chinese Trademark Law defines the actions that are considered to be infringement to include the use of a registered mark on counterfeit products or using marks identical to registered ones.⁵⁰ It provides a unique system to deal with infringement. First, it requires the disputing parties to try to resolve the problem through communication before making recourse to courts or asking the Administrative Authority for Industry and Commerce ("AAIC") to take action with regard to the infringement.⁵¹ If consultations fail to produce an amenable result, then recourse can be sought from the AAIC.⁵² If the disputing party is not satisfied with the decision of the AAIC, it can file a claim in court.⁵³ The Chinese Trademark Law grants the AAIC the power to investigate, inspect, and handle infringement cases unless the infringement action constitutes a crime.⁵⁴ The Law also allows prompt precautionary measures by courts in the case of an infringement requiring immediate action.⁵⁵ The courts also handle cases of criminal infringement and those alleging an abuse of power by administrative agencies concerned with trademark issues.⁵⁶

A worth mentioning note here is the scope of application of the Chinese New Regulations and the Archiving Measures. Unlike other franchise laws that apply only to local franchises,⁵⁷ the Chinese New Regulations and the Archiving Measures apply to units outside of China.⁵⁸ This requirement, called the "two-plus-one" requirement, applies also to foreign franchisors.⁵⁹ Additionally, the Archiving Measures require all franchisors to submit to the filing authority documentation of the two direct sales stores whether located

46. Chinese Trademark Law, *supra* note 19, at art. 39.

47. *Id.*

48. *See generally id.*

49. *Id.* at art. 40.

50. *Id.* at art. 52.

51. Chinese Trademark Law, *supra* note 19, at art. 53.

52. *Id.* at art. 54.

53. *Id.* at art. 53.

54. *Id.* at arts. 54-55.

55. *Id.* at art. 58.

56. Chinese Trademark Law, *supra* note 19, at arts. 60-62.

57. *See generally* 16 C.F.R. § 436.2.

58. Jones & Wulff, *supra* note 5, at 58.; *See generally* Zhiqiong June Wang & Andrew Terry, *China's Long March to a Franchise Law: The 2007 Franchise Regulation*, 2007 LAWASIA J. 79, 92 (2007).

59. *See* Chinese Archiving Measures, *supra* note 10, at art. 17 (providing that "An overseas franchiser shall follow these Measures to conduct franchise activities within the territory of China").

inside or outside China.⁶⁰ Nevertheless, both the Chinese New Regulations and the Archiving Measures are silent as to the conditions the two direct-sale stores must meet, such as whether the two direct-sale stores must be owned by the same franchisor franchising in China or whether they can be run by an affiliate.⁶¹ It is also unclear whether this requirement must be met only at the commencement of a franchise operation or if it must continue during operation of the franchised outlets in China.⁶²

II. DRAFTING FRANCHISE AGREEMENTS IN CHINA:

On the one hand, there are no provisions in the New Regulations applying to letters of intent or any other pre-contractual stage of a franchise transaction.⁶³ The general Chinese contract and tort laws apply to liability arising in pre-contractual negotiations, giving franchisees the right to void the franchise agreement in different situations such as in cases of fraud or misrepresentation in disclosure documents.⁶⁴ Franchisors may also be held

60. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 96. *See also* Chinese New Regulations, *supra* note 21, at art. 7. (stating Article 7 of the Chinese New Regulations provides that “[a] franchisor for engaging in franchise activities shall have two direct sales stores at least, and have conducted such business for more than one year”); *See* Chinese Archiving Measures, *supra* note 10, at arts. 5-6, 17. (stating Article 17 of the Archiving Measures provides that “[f]ranchisors from abroad engaging in franchise activities in China shall abide by these Rules” and Articles 5 and 6 provide that A franchisor applying for archival filing shall submit the following documents to the archiving organ: certificates issued by a competent commercial department of a city divided into districts based on the provision in Paragraph 2 of Article Seven; where direct sales stores owned by the franchisor are located beyond the territory of China).

61. Jones & Wulff, *supra* note 5, at 58.

62. *Id.* *See also* Chinese New Regulations, *supra* note 21, at art. 24 (stating the Chinese New Regulations also provide for a penalty in case of non-fulfillment of the direct sales stores requirement. Article 24 provides that the violating party must revoke any action taken, pay a fine from 100,000 RMB to 500,000 RMB, and the commerce department may seize any profits); THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 99.

63. YU QIN & RICHARD L. WAGEMAN, *CHINA*, 8 (Andrew P. Loewinger & Michael K. Lindsey eds., 2011).

64. Article 869 of the Chinese Civil Code provides that “[d]uring the preliminary work, negotiations and other work conducted during the process of entering a contract, the parties shall have the duty of non-disclosure, protection and care according to the principle of good faith.” LIANG HUIXING, *THE DRAFT CIVIL CODE OF THE PEOPLE’S REPUBLIC OF CHINA, ENGLISH TRANSLATION 230* (Junwei Fu & Jacob S. Schneider eds., 2010). Article 870 provides that:

1. The party who violates the obligations provided in the preceding article which causes the contract not to be established, or to be invalid, revoked or not ratified, and causes the other party to suffer losses, shall be liable for damages under the following circumstances:
 - a. deliberately concealing important facts relating to the conclusion of the contract or providing deliberately false information;
 - b. disclosure or unjustified use of others’ business secrets which have been acquired or learned;
 - c. breaking off negotiation with obviously unjustified reasons or negotiating in bad faith;
 - d. violating the duty of protection which causes property damage or personal injuries to the other party;
 - e. causing the non-establishment or ineffectiveness of the contract while the other party rationally believes without fault that the contract may be established or effective;
 - f. other circumstances that obviously violate the principle of good faith.

liable under the advertising law for any fraud or misrepresentation contained in the disclosure documents.⁶⁵ Moreover, the only pre-contractual liability organized by the Chinese law arises with respect to actual damages arising from franchisors' failure to comply with disclosure requirements.⁶⁶ On the other hand, the Chinese franchising laws are silent on the issue of liability arising from the breach of a franchise agreement.⁶⁷ This does not seem to be a problem since the general rules of liability of the civil code would apply.

Similarly, indemnification clauses are determined by the contract parties and are regulated by the provisions of the agreement in question.⁶⁸ Also, Chinese law does not provide penalties for general breaches of duty, only for specific breaches of the particular duties mentioned in the text.⁶⁹ Most remedies provided by the Chinese New Regulations are financial.⁷⁰

An issue worth discussing here is good faith and fairness requirements in franchise agreement. Thus, good faith is dealt with in the Chinese Contract Law.⁷¹ The General Principles of the Civil Law⁷² require contracting parties to abide by the doctrine of good faith while performing any of the obligations arising from their contractual relationship.⁷³ Further, Chinese scholars consider good faith to be one of the most important principles in Chinese

2- The party who violates the duties regulated in the preceding paragraph and causes property damages or personal injuries to the other party or other closely related party shall be liable for damages.

3- when the People's Court confirms the pre-contractual liability regulated in the subsection (1) of this provision, normal business risks and transaction usage shall be taken into account.

Id. at 230-31. Article 871 provides that: the method of pre-contractual liability shall be the payment of damages, the scope of which covers the loss incurred by the fact that one party relies on the validity of contract, but due to the negligence of the other party the contract is not established, or is ineffective, revoked or not ratified, and shall include the necessary expense for concluding the contract and the loss from the failure to take other opportunities for concluding the contract. *Id.*

65. See generally Advertisement Law of the People's Republic of China (promulgated by the Standing Comm. of the Nat'l People's Cong., Oct. 27, 1994, effective Feb. 1, 1995), <http://www.asianlii.org/cn/legis/cen/laws/alotproc432/> (Asianlii.org) (China) (showing Misrepresentation constitutes a violation and the specified sanctions that apply).

66. HUIXING, *supra* note 64, 230.

67. See generally Chinese New Regulations, *supra* note 21.

68. Chinese Contract law, *supra* note 13, arts. 407-08.

69. See generally Chinese New Regulations, *supra* note 21.

70. See *id.* art. 24.

71. Chinese Contract Law, *supra* note 13, at art. 6. See also MARTIN MENDELSON ET AL., FRANCHISING LAW 391 (Martin Mendelsohn, ed., Richmond Law & Tax, 2d ed. 2004).

72. Prior to the adoption of the Chinese Contract Law, China had enacted the Economic Contract Law in 1981, the Foreign Economic Contract Law in 1985, and the Law on Technology Contracts in 1987. DANIEL C. K. CHOW ET AL., THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 337-39 (2003) (stating that the various Chinese contract laws were enacted in an effort to support China's transition from a planned economy to a transition economy, as part of Deng Xiaoping's economic reforms after the end of the Cultural Revolution in 1976).

73. Chunlin Leonhard, *A Legal Chameleon: An Examination of the Doctrine of Good Faith in Chinese and American Contract Law*, 25 CONN. J. INT'L L. 305, 309-10 (2010) (citing Wang Liming & Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 COLUM. J. ASIAN L. 1, 4 (1999)).

contract law.⁷⁴ Good faith in the Chinese legal system covers all stages of contracting, from pre-contractual negotiations through performance and the post-termination stage.⁷⁵ The principle of good faith is considered the most effective guarantee of contractual performance.⁷⁶ It also guides the courts when filling the gaps in Chinese law, particularly because fast social and economic changes take place in China and require legal response.⁷⁷ For instance, in *Chong Qing City Cheng Kou County Lan Tian Village Nursery v. China Agricultural Bank Cheng Kou*, the plaintiff asked the defendant bank to extend its loan but the bank refused because it thought the plaintiff's failure to pay his previous loan made such an extension too risky.⁷⁸ The plaintiff claimed a breach of good faith.⁷⁹ The lower court decided that refusing to lend to the plaintiff did not breach the principle of good faith.⁸⁰ The three main elements that the court considered were whether the defendant intended to enter into an agreement with the plaintiff, whether the defendant intended to harm the plaintiff, and whether the defendant participated in any activity that affected interests of the plaintiff.⁸¹ The appellate court reversed the decision, though, because the bank had failed to respond timely to the plaintiff's request, constituting a breach of good faith during the pre-contractual stage.⁸² The appellate court observed that, "during the process of forming a loan contract, both parties to the potential contract owe each other a duty of care, such as mutual assistance, mutual care, mutual protection, and mutual notification, which is consistent with the principle of good faith."⁸³ In addition to the general rules of contracts, the Chinese franchise law explicitly provides for the importance of good faith in franchise transactions.⁸⁴ The Chinese New Regulations require franchising parties to act in accordance with the principles of "free will, fairness, honesty and good faith."⁸⁵

Furthermore, the Chinese New Regulations require that the franchise agreement be in writing.⁸⁶ In the same context, the Chinese laws require inclusion of specific information in a franchise agreement that, if absent,

74. *Id.* at 309.

75. *Id.* at 311.

76. *Id.* at 310-11.

77. *Id.* at 311.

78. Leonhard, *supra* note 73, at 317-18.

79. *Id.*

80. *Id.* at 318.

81. *Id.*

82. *Id.*

83. Leonhard, *supra* note 73, at 318.

84. Chinese New Regulations, *supra* note 21, at art. 4.

85. Chinese New Regulations, *supra* note 21, at art. 4. See also SPENCER, *supra* note 8, at 185.

86. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 98. See also Chinese New Regulations, *supra* note 21, at art. 11 (providing that "For engaging in franchise activities, the franchiser and the franchisee shall conclude a written franchise contract").

invalidates the agreement.⁸⁷ Necessary information includes that relating to the parties' information, fees, duration, termination of the agreement, training, operation standards, advertising, the parties' rights and obligations, and provisions regarding the settlement of disputes.⁸⁸ The reasons behind a writing requirement include facilitating the process of proof in future disputes and protecting franchisees, particularly in a country like China with variety of franchisees ranging from huge companies to small enterprises.⁸⁹

Concerning the duration of a franchise agreement, though the Chinese New Regulations set a minimum duration of three years for all franchise agreements,⁹⁰ this term is not mandatory since parties are allowed to agree otherwise.⁹¹ Though the Chinese New Regulations do not provide specific rules governing renewal of franchise agreements,⁹² it give the franchisee the right to transfer his franchise with the franchisor's consent.⁹³ The Chinese law is criticized to be silent in this regard because requiring franchisors to accept renewal if requested by franchisees—unless the franchisor has good cause to decline—protects franchisees.⁹⁴ Similarly, the law is silent on transfer of a franchise agreement.⁹⁵ Usually, contracts leave the issue of transfer to be dealt with through the contractual relationship. However, regulating the issue of transfer of a franchise agreement helps to avoid any legislative gaps. Franchisees, in general, shall not be allowed to transfer the franchise agreement except with authorization from the franchisor.⁹⁶ The reason behind this seems to be that a franchisor is not required to accept a contracting party he did not choose. In the same context, the law should also require a franchisee to grant the franchisor the right of first refusal before offering transfer of the franchise to a third party.

Finally, termination rules in the Chinese New Regulations favor franchisees.⁹⁷ For instance, Article 12 allows the franchisee to terminate a franchise agreement, by his own will, following a specific period after the

87. Chinese New Regulations, *supra* note 21, at art. 11.

88. *Id.* at art. 19.

89. *Id.* at art. 11.

90. SPENCER, *supra* note 8, at 184.

91. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 98. *See also* Chinese New Regulations, *supra* note 21, at art. 13 (providing that “[u]nless it is otherwise agreed upon by the franchisee, the franchise term as stipulated in the franchise contract may not be less than three years. When the franchisor and the franchisee renew the franchise contract, the preceding paragraph may not apply”).

92. *See generally* Chinese New Regulations, *supra* note 21.

93. *Id.* at art. 18. *See also* SPENCER, *supra* note 8, at 185.

94. Chinese New Regulations, *supra* note 21, at art. 13.

95. *See generally* Chinese New Regulations, *supra* note 21.

96. *Id.* at art. 18.

97. *Id.* at art. 12.

date of signing the agreement.⁹⁸ Also, Article 23 gives the franchisee the right to terminate the franchise agreement if the franchisor hides any information or gives any wrong information that he is required to disclose under the Chinese New Regulations.⁹⁹

III. THE ASSOCIATED PROCEDURAL ASPECTS OF THE CONCLUSION OF A FRANCHISE TRANSACTION IN CHINA

Disclosure and registration systems usually require franchisors to submit disclosure documents before signing franchise agreements.¹⁰⁰ The Chinese Contract Law lays down a general rule of disclosure by providing that if any of the parties cause loss to the other by concealing information or providing false information, that party shall be liable for damages.¹⁰¹ In *Huang Haiyan v. Beijing Hansen Cosmetology Co.*, the plaintiff claimed that the franchisor gave him false information that the trademark of the franchised cosmetic shop was internationally famous and was registered.¹⁰² The plaintiff claimed the defendant gave him misleading information to encourage him to enter the franchise agreement and that that constituted a breach of the duty to disclose.¹⁰³ The Beijing Chaoyang District People's Court confirmed that the franchisor violated disclosure rules and declared the agreement null.¹⁰⁴ The court explained that the purpose of disclosure is to help franchisees become more familiar with the franchised business and to help them decide whether to accept a franchise offer.¹⁰⁵ Accordingly, violating the duty to disclose is fraud.¹⁰⁶ Additionally, the Chinese New Regulations lay down the main principles governing disclosure and refer to the Chinese Disclosure Measures for more details on how to establish a comprehensive disclosure system.¹⁰⁷

Similarly, the Chinese New Regulations and the Chinese Measures for the Administration of Information Disclosure require franchisors to submit both the franchise contract and disclosure documents thirty days before the

98. *See id.* at art. 12. (providing that “[i]t shall be stipulated in the franchise contract concluded between the franchisor and the franchisee that the franchisee may unilaterally terminate the contract within a certain term after the franchise contract has been signed”).

99. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 98. *See also* Chinese New Regulations, *supra* note 21, at art. 23.

100. Chinese Contract Law, *supra* note 13, at art. 43.

101. *Id.*

102. Jones & Wulff, *supra* note 5, at 60 (summarizing the case of *Huang Haiyan v. Beijing Hansen Cosmetology Co.*).

103. *Id.*

104. *Id.* at 61.

105. *Id.*

106. *Id.*

107. Chinese New Regulations, *supra* note 21, at art. 20 (providing that “[a] franchisor shall set up and carry out disclosure in accordance with the provisions as prescribed by the commerce department of the State Council”).

conclusion of a franchise contract.¹⁰⁸ In the same context, the Measures require the franchisor to give precise and confirmed information and in case of any change to any of the disclosed information, to notify the franchisee.¹⁰⁹ The said period sounds reasonable providing sufficient time for franchisees to make a final decision after an opportunity to review all the documents provided by the franchisor.

Meanwhile, the Chinese Measures provide for a franchisor's right to include a confidentiality agreement with the franchisee before disclosing any information to him.¹¹⁰ In the same context, the Measures require the franchisee to issue the franchisor a receipt, to be signed by both parties, that the franchisee received the disclosure documents.¹¹¹ The proposed Egyptian franchising law should also require the franchisee to issue the franchisor a receipt for the disclosure documents.

The Chinese New Regulations also provide for a penalty in case of serious breach, in addition to making the franchisor take action to correct the breach.¹¹² The Chinese Measures for the Administration of Information Disclosure provide for a similar sanction in addition to allowing the franchisee to terminate the franchise agreement.¹¹³

Concerning the contents of the disclosure document, the Chinese New Regulations provide a list of information required to be disclosed.¹¹⁴ This includes information related to the franchisor's name, domicile, legal representative, registered capital, business scope, commercial franchise activities, and basic information on previously archived disclosures.¹¹⁵ It also requires disclosure of all information on any associated company that provides goods or services to the franchisor and bankruptcy information for the franchisor or its associated company for the previous five years.¹¹⁶ Additionally, records of any illegal business operations, financial and accounting reports, any audit reports from the last two years, and records of any major illegal operation of the franchisor that resulted in fines or imprisonment must be disclosed.¹¹⁷ Furthermore, disclosure is required of digests of the financial statements for the last two years, the investment

108. *Id.* at art. 7. *Contra* Chinese Measures for the Administration of Information Disclosure, *supra* note 11, at art. 4.

109. Chinese New Regulations, *supra* note 21, at art. 23.

110. *See* Chinese Measures for the Administration of Information Disclosure, *supra* note 11, at art. 7.

111. *Id.* at art. 8.

112. *Id.* at art. 10.

113. *Id.*

114. *Id.* at art. 5. *See also* THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 97.

115. Chinese New Regulations, *supra* note 21, at art. 22. *See also* THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 97.

116. Chinese Measures for the Administration of Information Disclosure, *supra* note 11, at art. 5.

117. Chinese New Regulations, *supra* note 21, at art. 22.

budget for the franchise outlet, quantity, distribution and business evaluation of franchisees currently existing in China, and information on the franchise agreement.¹¹⁸ This includes the type and amount of franchising fees and payment methods, prices and requirements for providing the franchisee with products, services and equipment, a sample franchise contract, and basic information on the franchise expenditure.¹¹⁹

Though the Regulations' provisions on disclosure are self-explanatory, the list above is not exclusive.¹²⁰ That is important because Article 42 of the Contract Law of China provides that if any of the contracting parties intentionally hide any relevant information or provide false information, they should be responsible for any losses.¹²¹ A good example is found in the case of Huang Haiyan, where the plaintiff found out that the trademark, associated with the franchised products, was not registered and was not an international brand, as claimed by the franchisor.¹²² The plaintiff found also that there were hidden issues with the supply of products.¹²³ The court decided that a written disclosure of basic information should have been provided in advance by the franchisor.¹²⁴ The court explained that the main goal of disclosure is to enable the franchisee to understand the objectives of the franchised business and to be able to evaluate the franchise offer.¹²⁵ Accordingly, it is considered fraudulent action if the franchisor violates disclosure requirement, taking into consideration the remedies of Article 42 of the Contract Law of China.¹²⁶

Finally, the Chinese Archiving Measures require the franchisor to submit specific documents to the Ministry of Commerce within fifteen days of the date on which the franchise agreement is concluded.¹²⁷ The Chinese Archiving Measures list the documents that the franchisor must submit to register the franchise agreement.¹²⁸ These documents include primary information on the transaction, potential franchised outlets in China, working license, trademark registration certificate, the two-plus-one requirement, a copy of the franchise agreement, a description of the operations manual, any required approvals, and a commitment certificate issued and sealed by the

118. Chinese Measures for the Administration of Information Disclosure, *supra* note 11, at art. 5.

119. *Id.*

120. See SPENCER, *supra* note 8, at 201.

121. Chinese Contract Law, *supra* note 13, at art. 42.

122. See Jones & Wulff, *supra* note 5, at 7. (citing Wang Liming & Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 COLUM. J. ASIAN L. 1, 4 (1999).)

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. THE CENTER FOR INTERNATIONAL LEGAL STUDIES, *supra* note 23, at 97. See also Chinese Archiving Measures, *supra* note 10, at art. 6.

128. Chinese Archiving Measures, *supra* note 10, at art 5.

franchisor's legal representatives.¹²⁹ Some of these documents must be filed online while others are required to be submitted in hard copy.¹³⁰ Article 7 of the Chinese Archiving Measures provides that if any of the information supplied by the franchisor changes, the franchisor must apply for "alteration" within thirty days.¹³¹ Moreover, Article 8 requires the franchisor to report any changes to the franchise agreement by March 31 of each year.¹³² Furthermore, Article 9 requires the franchisor to confirm the clarity, completeness, and validity of all submitted documents.¹³³

Registration rules require franchisors to register their documents including the franchise agreement, disclosure documents, operations manual, training manual, and financial statements, before franchise offers are made.¹³⁴ This would provide more authentication and reliability for franchise documents. Accordingly, once the franchisor submits the required documents, the competent authority shall archive the documents within ten days of submission unless the documents are incomplete.¹³⁵ After that, the competent authority must notify the Ministry of Commerce of the registration within ten days.¹³⁶ Article 13 requires the competent authority to keep any documents or information submitted by the franchisor confidential; however, Article 14 allows specific identifying information to be available online to the public.¹³⁷

The Chinese New Regulations and the Chinese Measures for Administration of Information Disclosure impose different types of penalties and procedures depending on the degree of the breach if the registration rules are violated.¹³⁸ Article 4 of the Chinese Measures for Administration of Information Disclosure allows anybody to report a violation.¹³⁹ Article 11 grants authority to cancel registration for violation of the disclosure requirements.¹⁴⁰ Also, a fine applies if payment is not made within a fixed period may be imposed.¹⁴¹ A special fine exists for violating the obligation

129. *Id.*

130. *Id.*

131. *Id.* at art. 7.

132. *Id.* at art. 8.

133. Chinese Archiving Measures, *supra* note 10, at art. 9.

134. *Id.* at art. 5.

135. *Id.* at art. 10.

136. *Id.*

137. *Id.* at art. 13-14.

138. *See* Chinese New Regulations, *supra* note 21, at art. 24-30. *See also* Chinese Measures for the Administration of Information Disclosure of Commercial Franchises, *supra* note 11, at art. 10.

139. Chinese Measures for the Administration of Information Disclosure of Commercial Franchises, *supra* note 11, at art. 4.

140. *Id.* at art. 10.

141. Chinese New Regulations, *supra* note 21, at art. 15. *See also id.*

to notify the competent authority of any change in the franchise agreement, in addition to making all required corrections.¹⁴²

Penalties are important to make the registration rules more effective. Registrars generally should be given the power to investigate and take any other required measures to ensure the veracity of the information provided. In the same context, the Registrar should be granted the right to withdraw registration if franchisors do not correct any deficiencies that they are notified of by the Registrar. Similarly, to guarantee effective enforcement of the registration rules, the law should allow the Registrar to conduct investigations in case of breach of registration rules, such as providing misleading documents for registration. Also, penalties for submitting false or misleading information to the Registrar and for breaching any of the registration rules provided by the law is a must.

142. See Chinese Measures for the Administration of Information Disclosure of Commercial Franchises, *supra* note 11, at art. 10.