



**PRC Retail Law Newsflash**  
**13 March 2007**

**Newsflash: China's New Franchise Regulations**

On 6 February 2007, the PRC State Council promulgated the *Regulations for the Administration of Commercial Franchises* (**New Regulations**), which will come into effect on 1 May 2007.

**Background**

On 31 December 2004, the Ministry of Commerce (**MOFCOM**) issued the *Measures Regarding the Administration of Commercial Franchises* (**Measures**) which became effective as of 1 February 2005, and which had served as the only legislation governing this developing sector.

By the end of 2005, the China Chain Store & Franchise Association reported that there were 2,320 franchisors and 168,000 franchisees in China covering over 60 industries.

The New Regulations may be read together with the Measures but, in the event of any inconsistency, the New Regulations (being issued by a higher level of authority) will prevail. For those issues on which the New Regulations are silent, the Measures can be referred to accordingly.

**Key Provisions of the New Regulations**

- **Franchising:** "Franchising" is the business activity in which a franchiser, with a franchising fee serving as consideration, confers to a franchisee the right to use its business resources, such as its trademark, trade name and business model.
- **Qualifications:** A franchiser must independently own and operate at least 2 stores for more than 1 year before it may qualify to engage in the franchise business. Unlike the earlier Measures, the New Regulations do not allow franchisors to use stores owned and operated by its subsidiaries or holding company(ies) to satisfy this requirement. Further, the New Regulations state that the MOFCOM will publish and update a comprehensive list of qualified franchisors on its website, in order for franchisees to easily verify the qualifications of existing or potential franchisors.
- **Disclosure Requirements:** The franchiser must, 30 days prior to the signing of a franchise agreement, provide the franchisee with basic information about the franchiser and its legal representative (such as credit records, operational resources, service capacity, investment budget for the franchised outlets, etc.). Specifically, any information regarding cash flow and finances must be audited by an accounting firm.

- **Franchise Agreement:** A franchiser is required to file its first franchise agreement with the MOFCOM or its local bureaus (as applicable) within 15 days of its execution. All subsequent franchise agreements must be submitted on the first quarter of each year.

A franchiser is also required to provide the franchisee with a “cooling off period” in the agreement, during which time the franchisee may unilaterally elect to terminate the agreement. While the new “cooling off period” requirement provides the franchisee with an “exit”, the circumstances for termination (*e.g.*, inevitable loss of profits, misrepresentation by the franchiser or any commercial considerations) are not specified, nor are there any mandatory provisions requiring the franchiser to refund the franchise fees to the franchisee, which places the franchisee in a disadvantaged position.

### **Commentary**

The New Regulations provide various new provisions which cover areas not addressed in the Measures, and which may have a differing impact on the parties to a franchise agreement.

- **Application:** The New Regulations apply to all enterprises engaged in franchising within China. Based on our discussion with MOFCOM, we understand that, a distribution business whereby the so-called “franchisor” charges, for example, a margin mark-up for distribution of merchandise, but not a “franchising fee”, does not fall under the scope of the New Regulations.
- **Non-Retrospective Effect:** In order to soften the impact of the New Regulations on existing franchises, the “2 stores for 1 year” requirement is waived for franchise agreements signed prior to 1 May 2007.

However, based on our discussion with MOFCOM officials, we understand that, if existing franchisers wish to expand their current franchising activities (*e.g.*, renewal of the franchise agreement, or signing of more franchise agreements), the “2 stores for 1 year” requirement would apply.

Notwithstanding the improvements promised by the New Regulations, certain issues have yet to be clarified by the authorities (such as the “cooling off period” provision mentioned above). These issues are expected to be addressed by the relevant authorities during their implementation of the New Regulations. However, prior to further clarification, in order to avoid any potential disputes arising out of these current uncertainties, it is imperative for all vital issues to be specified clearly in the franchise agreement.

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This newsflash was coauthored by Cameron Andersen and Emilie Niu in Shanghai.

We trust that you find these newsflash useful. If you have any questions on these subjects or any other area of retail law, please contact:

- June Lei ([jlei@TransAsiaLawyers.com](mailto:jlei@TransAsiaLawyers.com)); or
- Tan Joon Ho ([jhtan@TransAsiaLawyers.com](mailto:jhtan@TransAsiaLawyers.com)).

Full English translation of any aforementioned PRC legislation as well as other rules and regulations are available for purchase upon request.

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## **TransAsia Lawyers**

### **Beijing**

Suite 2218 China World Tower 1  
1 Jianguomenwai Avenue  
Beijing 100004, China  
Tel: (86 10) 6505-8188  
Fax: (86 10) 6505-8189 / 98

### **Shanghai**

Unit 1101 Platinum  
233 Tai Cang Road  
Shanghai 200020, China  
Tel: (86 21) 6141-0998  
Fax: (86 21) 6141-0995 / 6

<http://www.TransAsiaLawyers.com>

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