



TO: OUR FRANCHISE AND DISTRIBUTION CLIENTS AND FRIENDS

FROM: GRAY PLANT MOOTY'S FRANCHISE AND DISTRIBUTION PRACTICE GROUP

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SOUTH KOREA ADOPTS FRANCHISEE PROTECTIONIST LEGISLATION

In an apparent response to increased competition within certain segments of the restaurant and bakery industries, the Korean National Assembly recently passed an Amendment to the Fair Transactions in Franchise Business Act creating unique franchise relationship and disclosure requirements. The new law addresses unit remodeling requirements, business (protected) territories, sales revenue projections, business hours, franchisee "trade unions" and refunds. The Amendment will become effective February 14, 2014, except for requirements involving the business territory, which become effective later in 2014. Shortly before the effective date, a Presidential Decree is expected to be issued that will provide additional detail of the Amendment's requirements. The provisions of the Presidential Decree will be significant in that they will impact, among other matters, the eventual scope of key provisions of the Amendment.

Based on our review of local counsel summaries of the Amendment, the following are key aspects:

Remodeling Cost-Sharing Now Required by Franchisor

A franchisor requesting that a franchisee remodel the franchised store must now bear up to 40 percent of the remodeling cost. The anticipated Presidential Decree will determine the specific percentage of the franchisee's remodeling costs that the franchisor must bear. The Presidential Decree is expected to follow the 2012 Model Franchise Transaction Standards in



setting cost-sharing percentages and the frequency of requiring remodeling, but the Presidential Decree will go one step further in mandating franchisor compliance rather than leaving it optional. The Model Standards were established as nonbinding guidelines for franchisors and franchisees in the bakery, pizza, chicken, and coffee industries. The franchisor's share of remodeling costs varies by industry under the Model Standards, which stipulate that franchisors contribute between 20 to 40 percent of the remodeling costs. The Model Standards also restricted a franchisor from requiring remodeling more frequently than once every five to seven years. Similar cost-sharing standards will apply when the franchisor requires a franchisee to relocate or expand a store without reasonable cause. Franchisors will not be required to share costs for remodeling or upgrading that a franchisee voluntarily performs or must make in response to sanitation or other safety concerns.

Franchise Agreements Must Stipulate Franchisees' Business (Protected) Territories

Before the Amendment, the Act did not require franchisors to define a business (protected) territory in the franchise agreement. In a change that becomes effective August 14, 2014, the Amendment will require franchisors to define explicitly and stipulate the franchisee's business (protected) territory in each franchise agreement. During the term of a franchise agreement, a franchisor may not directly or indirectly (through an affiliate or third party franchisee) establish a store for the same type of business within the franchisee's business territory without justifiable cause. In addition, the Presidential Decree may restrict the proximity of new retail outlets to existing franchised outlets. Upon renewal of a franchise, the business territory may be reasonably adjusted by negotiation for causes to be stipulated in the Presidential Decree.

The full scope of the changes regarding business (protected) territory restrictions remains unclear pending the Presidential Decree. Reports suggest that certain restrictions may be imposed only on large franchisors and/or franchisors in the food services industries. If the government follows the Model Standards, additional proximity restrictions will apply to franchisors in the food services industry (*i.e.*, bakery, pizza, chicken, and coffee) having over 1,000 units or having over 100 units with cumulative annual sales of over approximately \$91 million U.S. dollars.

New Disclosure Provisions on Sales Forecasts

Before the Amendment, franchisors were not required to provide franchisees with any information on sales or revenue projections, although any information franchisors elected to provide needed to be in writing. The Amendment now requires franchisors to provide information to prospective franchisees (and maintain the information for five years) on projected sales revenue and the method for its calculation. The Presidential Decree is expected to specify the calculation methodology for the projected sales



revenue disclosure. The Amendment makes an exception to the sales forecast requirements for “small and medium enterprises” and those franchisors having less than a certain number of franchised stores. The Presidential Decree will identify the threshold number of stores required for compliance. The Amendment also increases the amount of fines which may be imposed on franchisors for providing false or exaggerated information.

Restrictions on Reasonable Business Hours

The Amendment prohibits franchisors from refusing to grant a franchisee’s request for reduced business operating hours in certain circumstances. A franchisee may deviate from established business hours if the profits generated from nighttime operations do not cover the cost of operating a franchised store at night. A franchisee also may operate for reduced operating hours if unavoidable circumstances, such as illness, prevent normal operations of a franchised store.

Franchisees within a System Can Form a Union

The Amendment allows franchisees belonging to the same franchise system to form a “trade union” and to protect their rights and advance their status through collective bargaining with the franchisor regarding the terms and conditions of their franchise relationships.

Extended Time Period for Franchise Fee Refunds

Under the Act, franchisors must refund franchise fees in certain statutorily defined circumstances (*e.g.*, for providing false or misleading information). Previously, franchisees seeking a refund of the franchise fees were required to make a written request within two months following the date they signed the franchise agreement. The Amendment extends this refund period to four months.

Impact on U.S.-based Franchisors

Franchisors considering expansion into South Korea must consider the impact of the Amendment and the current environment for franchising in South Korea. The anticipated Presidential Decree will provide greater certainty for franchisors in a market that, in the past decade, has been a favorite landing spot for foreign franchisors.

If you need additional information about the Amendment or franchising in South Korea, please contact Carl Zwisler (Carl.Zwisler@gpmlaw.com), Gaylen Knack (Gaylen.Knack@gpmlaw.com), or Sandy Bodeau (Sandra.Bodeau@gpmlaw.com).



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