

## Measures for the Regulation of Commercial Franchise

### Chapter I. General Provisions

#### **Article 1**

These measures are promulgated for the purposes of regulating commercial franchise operations, protecting the legitimate interests of the parties involved, and promoting the healthy and orderly development of commercial franchising.

#### **Article 2**

Commercial franchise (hereinafter “**franchise**”) refers to an arrangement whereby a franchisor, through an agreement with a franchisee, grant the franchisee the right to use business operating resources including trademarks, trade names, operational model, and etc., which the franchisor has the right to grant to others to use. The franchisee shall operate under the uniform franchise system according to the agreement and pay franchise fees to the franchisor.

#### **Article 3**

These Measures apply to franchise operations within the People’s Republic of China.

#### **Article 4**

A franchisor can, in accordance with the agreement, grant a franchise directly to a franchisee, who will establish and operate a franchised unit but cannot further grant the franchise; or, grant a franchise exclusively to a franchisee within a certain territory, who in turn can further grant the franchise to other prospective franchisees, or establish and operate franchised units by itself.

#### **Article 5**

Franchise operations shall be conducted under the laws and regulations of the People’s Republic of China, in accordance with the principles of voluntariness, fair dealing, honesty, and trustworthiness. Consumers’ legitimate interests shall not be harmed.

A franchisor shall not engage in illegal direct marketing activities under the name of franchise.

A franchisor, when engages in commercial activities through franchising, shall not cause market monopoly or impede fair competition.

#### **Article 6**

The Ministry of Commerce oversees and regulates franchise operations within the country. Commerce regulatory agencies of various levels oversee and regulate franchise operations within their respective jurisdictions.

## Chapter II. Parties to Franchise Operations

### **Article 7**

A franchisor shall have the following qualifications:

1. being an enterprise or other economic entity duly organized under the laws and regulations;
2. having the right to grant others to use business operating resources including trademarks, trade names, operational model, and etc.
3. having the capacity to provide franchisees with long-term operational guidance and training services;
4. having at least two company-owned units (or units owned by its subsidiary) in China for more than one year;
5. if the franchise requires supplying goods by the franchisor, having a supply system that is stable and can guarantee quality, as well as the ability to provide related services; and
6. having a good reputation, and no record of perpetrating fraud by utilizing the method of franchise.

### **Article 8**

A franchisee shall have the following qualifications:

1. being an enterprise or other economic entity duly organized under the laws and regulations; and
2. having the capital, fixed venue, personnel, and other qualities corresponding to the needs of the franchise operation to be engaged in.

### **Article 9**

A franchisor has the following rights:

1. to supervise the franchisee's operations in accordance with the franchise agreement so as to ensure the uniformity of the franchising system, as well as the consistency of the quality of the products and services;
2. to terminate the franchise in accordance with the franchise agreement for breach of contract, infringing the legitimate rights and interests of the franchisor, or damages caused by the franchisee to the franchise system;

3. to collect franchise fees and deposit; and
4. other rights pursuant to the franchise agreement.

#### **Article 10**

A franchisor has the following obligations:

1. to timely disclose information in accordance with these Measures;
2. to grant franchise to a franchisee, provide signage representing the franchise system, and provide an operation manual;
3. to provide a franchisee with guidance, training, and other services necessary for the development of the franchise business in the areas of sales, operation and technology;
4. to supply goods to a franchisee pursuant to the terms of the franchise agreement; provided that, except for monopolized goods and those goods that have to be supplied by the franchisor or its designated suppliers to ensure the quality of the franchise operations, the franchisor cannot force a franchisee to accept the franchisor as its supplier of goods; however, the franchisor can stipulate the standards of quality for the goods, or provide a list of suppliers from which a franchisee can choose;
5. to be liable for the goods supplied by its designated suppliers;
6. to provide promotional and advertising services pursuant to the terms of the franchise agreement; and
7. other obligations pursuant to the franchise agreement.

#### **Article 11**

A franchisee has the following rights:

1. to receive the right to use the business operating resources including trademarks, trade names, operational model, and etc.;
2. to receive training and guidance provided by the franchisor;
3. to timely receive goods supplied by or arranged by the franchisor at the contractual price;
4. to participate and receive support in system-wide promotions conducted by franchisor; and
5. other rights pursuant to the franchise agreement.

#### **Article 12**

A franchisee has the following obligations:

1. to conduct business in accordance with the franchise agreement;
2. to pay franchise fees and deposit;
3. to maintain the uniformity of the franchising system. Without authorization, the franchisee must not transfer the franchise;
4. to timely provide the franchisor with genuine information stipulated in the agreement, including operational results and financial information.
5. to accept guidance and supervision from the franchisor;
6. to keep the franchisor's trade secrets confidential; and
7. other obligations pursuant to the franchise agreement.

### **Chapter III. Franchise Agreement**

#### **Article 13**

A franchise agreement shall be concluded between the parties involved, which generally includes the following items:

1. the names and the addresses of parties;
2. the contents, term, location and exclusivity of the franchise to be granted;
3. the type, amount and payment method of the franchising fees, as well as the collection and refund of the deposit;
4. confidentiality provisions;
5. quality control and responsibility regarding the products and/or services;
6. training and guidance;
7. the use of the trade names;
8. the use of intellectual property rights, including the trademarks;
9. consumer complaints;
10. promotion and advertising;

11. amendment and termination of the franchise agreement;
12. default and its consequences;
13. dispute resolution; and
14. other provisions agreed by the parties.

#### **Article 14**

Franchise fees refer to the fees paid by a franchisee to obtain the franchise, including:

1. Initial Franchise Fee: a fee paid in lump sum by a franchisee to a franchisor for the franchise.
2. Royalty: a fee paid periodically by a franchisee to a franchisor in the course of operating the franchise, which is calculated according to a formula or standard.
3. Other agreed-upon fees: other fees paid by a franchisee to a franchisor to obtain the goods or services supplied by the franchisor.

Deposit refers to an amount paid by a franchisee to a franchisor in lump sum to ensure the franchisee's performance of the franchise agreement, which shall be refunded to the franchisee upon the expiration of the agreement.

The parties to a franchise agreement shall set the franchisee fees and deposit based on the principles of fair dealing and reasonableness.

#### **Article 15**

The term of a franchise agreement generally shall be at least 3 years.

Upon the expiration of a franchise agreement, the franchisor and the franchisee can negotiate the terms for the renewal of the franchise agreement based on the principles of fair dealing and reasonableness.

#### **Article 16**

Upon the termination of a franchise agreement, without the consent of the franchisor, the franchisee shall not: continue to use the trademarks, trade names, and other signage of the franchisor; register the franchisor's trademarks as the trademarks of similar products or service marks; use words identical or similar to the franchisor's registered trademarks as part of a trade name; or use signage identical or similar to the franchisor's registered trademarks, trade names, or store decor for identical or similar products or services.

### **Chapter IV. Information Disclosure**

### **Article 17**

Prior to the execution of a franchise agreement and during the course of franchise operation, franchisors and franchisees shall timely disclose relevant information.

### **Article 18**

A franchisor shall, at least 20 days before the execution of the franchise agreement, provide a prospective franchisee with a copy of the franchise agreement and a written disclosure document including the genuine and accurate basic information relating to the franchise operation.

### **Article 19**

The basic information disclosed by a franchisor shall include the following:

1. the franchisor's name, address, registered capital, scope of business, number of years engaging in franchising, audited financial statements, and information regarding tax payments.
2. number, locations, operational results of its franchisees; initial investments of a franchised unit; and the proportion of the former franchisees whose franchise are terminated against the total number of franchisees.
3. registration, usage, and litigations regarding the trademarks; information regarding business operating resources like trade names and operational model.
4. the type, amount, and payment method of the franchising fees, as well as the collection and refund of the deposit;
5. litigations in which the franchisor was or is involved for the last five years;
6. services or goods the franchisor can supply to the franchisee, and accompanying restrictions and conditions.
7. proof of capacities to provide the franchisee with training and guidance, as well as the current situation regarding training and guidance provided to the franchisees.
8. basic information of the principal officers of the franchisor, including whether they were subject to criminal penalties, and whether they were personally liable for the bankruptcy of companies.
9. Other disclosures requested by the franchisee.

A franchisor shall compensate for a franchisee's economic losses caused by its inadequate disclosures or misrepresentations.

### **Article 20**

The franchisee shall, at the request of the franchisor, disclose accurately information regarding the franchisee's operational capabilities, including proof of its legal status, credit history, proof of ownership, and etc. During the course of the franchise operation, the franchisee shall timely provide the franchisor with genuine information, like operational results, pursuant to the franchise agreement.

### **Article 21**

During the course of as well as after the franchise agreement, the franchisee and its employees shall not, without the consent of the franchisor, use, disclose, or allow others to use the trade secrets of the franchisor that are known to the franchisee.

### **Article 22**

Persons or prospective franchisees, who know the franchisor's trade secrets through the information disclosure by the franchisor but did not or have not signed the franchise agreement, shall have the obligation to keep the trade secrets confidential. Without the consent of the franchisor, such persons or prospective franchisees shall not disclose or transfer the franchisor's trade secrets.

## **Chapter V. Advertising**

### **Article 23**

A franchisor, in advertising, promoting, or offering franchise, shall keep the contents of such advertisements accurate, genuine and legal, and shall not deceive, omit any material facts, or make any representations that could be misleading.

### **Article 24**

When an advertisement of a franchisor or a franchisee contains, directly or indirectly, records, numbers, or other relevant information regarding the operational results or profits, such information shall be genuine, and relevant locations and timeframes shall be expressly disclosed.

### **Article 25**

Franchisors and franchisees shall not imitate the trademarks, scenes and lines in commercials, or other signage for identifying in any misleading, deceiving, or confusing way.

### **Article 26**

In promoting the franchise, a franchisor shall not exaggerate the benefits of the franchise operation or intentionally omit information regarding situations where the franchise operation might affect the interests of others.

## **Chapter VI. Oversight and Regulation**

### **Article 27**

Commerce regulatory agencies at various levels shall strength the regulation and coordination of the franchise operations within their respective jurisdictions, and instruct the work of the local trade organizations.

Commerce regulatory agencies at various levels shall establish a credit history for franchisors and franchisees, and publish the names of the enterprises that have violated the relevant laws and regulations.

### **Article 28**

Franchise trade organizations shall adopt codes of ethics for the industry, conduct self-regulation, provide services to franchise parties, and promote the development of the industry.

### **Article 29**

Every January, a franchisor shall file a report with both the commerce regulatory agencies of its locality as well as that of the franchisee's locality, disclosing the information regarding the franchise agreements signed in the preceding year. Such commerce regulatory agency then shall report the filings to the supervising commerce regulatory agency.

### **Article 30**

If franchise operation involves patents, the parties shall enter into a patent licensing agreement in accordance with the *Patent Law of the People's Republic of China* and its implementing rules, and register in accordance with the *Measures for the Registration of Patent Licensing Agreements*.

### **Article 31**

Before engaging in franchise operation, a franchisor shall register the trademark licensing agreement in accordance with the *Trademark Law of the People's Republic of China* and its implementing rules.

## **Chapter VII. Special Rules for Foreign-invested Enterprises**



### **Article 32**

A foreign-invested enterprise (hereinafter “FIE”) shall not engage in franchise operations in the industries listed as “prohibited” in the *Catalog of Industries for Foreign Investment*.

### **Article 33**

FIEs that intend to engage in commercial activities by franchising shall apply to the original registration agency for expanding the business scope to include “engaging in commercial activities by franchising”, along with the following documents:

1. application letter and board resolution;
2. photocopies of the business license and FIE approval certificate;
3. amendment of the contract or the articles of incorporation (wholly-owned foreign enterprises only need to submit amendments to the articles of incorporation);
4. materials proving the requirements of Article 7 of these Measures;
5. materials reflecting the requirements of Article 19 of these Measures;
6. form franchise agreement; and
7. franchise operating manual.

The registration agency shall approve or disapprove the application in writing within 30 days after the receipt of all the application materials.

After being approved, FIEs shall register with the Administration for Industry and Commerce for amendment to their registrations within one month after the receipt of the new FIE approval certificate.

### **Article 34**

Every January, an FIE approved to engage in commercial activities by franchising shall file a report with both the original registration agency and the commerce regulatory agencies of the franchisee’s locality, disclosing the information regarding the franchise agreements signed in the preceding year.

### **Article 35**

Foreign investors, in establishing FIEs engaging in commercial activities by franchising, shall comply with the laws, regulation and rules on foreign investments, in addition to these Measures.

### **Article 36**

FIEs that have already been engaging in commercial activities by franchising shall file a report of their franchise operations so far to the original registration agency. If such FIEs want to continue to engage commercial activities by franchising, they shall finish the relevant procedures provided in these Measures.

### **Article 37**

Hong Kong, Macao, and Taiwan invested enterprises engaging in commercial activities by franchising shall comply with these Measures.

## **Chapter VIII. Legal Liabilities**

### **Article 38**

For violations of Article 7 or Article 8, commerce regulatory agencies shall impose orders to comply, and/or fines of less than RMB30,000; and shall inform the Administration for Industry and Commerce to cancel the business license if the violations are serious.

### **Article 39**

For failure to disclose information pursuant to these Measures, commerce regulatory agencies shall impose orders to comply, and/or fines of less than RMB30,000; and shall inform the Administration for Industry and Commerce to cancel the business license if the violations are serious.

### **Article 40**

Franchisors conduct advertising and promotion in violation of these Measures shall be punished according to the *Advertisement Law of the People's Republic of China* and other relevant laws, administrative regulations and rules.

## **Chapter IX. Supplemental Provisions**

### **Article 41**

These Measures shall be interpreted by the Ministry of Commerce.

### **Article 42**

These Measures will go into effect on February 1, 2005, and will replace the *Interim Measures of the Regulation of Commercial Franchise Operations* promulgated by the Ministry of Domestic Trade.