

# FRANCHISE

## South Korea



# Franchise

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Quick reference guide enabling side-by-side comparison of local insights, including franchise market overview; key considerations when forming and operating a franchise; offer and sale of franchises; franchise contracts and the franchisor/franchisee relationship; and recent trends.

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## MARKET OVERVIEW

### Franchising in the market

How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is widespread in Korea and is growing every year. According to statistical data provided by the Korea Fair Trade Commission (KFTC), in 2021, there were about 11,218 registered concepts owned by 7,342 franchisors and operated at 270,485 franchised units. The KFTC perceives that the 58.1 per cent increase in the number of brands was due to a recent amendment to the Franchise Act, which now imposes the obligation to register franchise disclosure documents on small-scale franchisors, and requires any franchisors who intend to register franchise disclosure documents to have at least one year of experience in operating at least one or more directly managed units by that franchisor. Meanwhile, franchising is most prevalent in the food services industry, followed by the service (eg, language education), wholesale and retail industries (eg, convenience stores, cosmetics).

*Law stated - 12 May 2022*

### Associations

Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Korea Franchise Association (KFA) is a non-profit organisation licensed by the Ministry of Trade, Industry and Energy. Its role is to promote the sound development of the franchise industry, mutual growth between franchisors and franchisees, and assist the globalisation of national brands. A franchisor that has registered its disclosure document with the KFTC can join as a member of the KFA and must abide by the KFA's rules of ethical conduct.

*Law stated - 12 May 2022*

## BUSINESS OVERVIEW

### Types of vehicle

What forms of business entities are relevant to the typical franchisor?

The stock company and the limited liability company are the business forms in Korea that would be relevant to a typical franchisor. About 90 per cent of Korean companies are stock companies, which are similar to US stock companies. Only this legal entity, plus occasionally the limited liability company, is recommended for foreign investors and businesses.

*Law stated - 12 May 2022*

### Regulation of business formation

What laws and agencies govern the formation of business entities?

Primarily, the Korean Civil Act and Korean Commercial Code govern the formation of business entities. In addition, the Foreign Investment Promotion Act relates to the formation of business entities from foreign investment.

The Korean Court Commercial Registrar, the National Tax Service, and the Ministry of Trade, Industry and Energy are the main agencies that have authority related to the formation of business entities in Korea.

*Law stated - 12 May 2022*

## Requirements for forming a business

Provide an overview of the requirements for forming and maintaining a business entity.

There is no minimum paid-up capital for a stock company or a limited liability company. Registration is with the Court Commercial Registrar and National Tax Service. In the case of investment by foreign business entities or foreigners, the investment must be reported to the Ministry of Trade, Industry and Energy (in practice, the function of receiving reports is delegated to designated foreign exchange banks or the Korea Trade-Investment Promotion Agency).

*Law stated - 12 May 2022*

## Restrictions on foreign investors

What restrictions apply to foreign business entities and foreign investment?

A foreigner may freely carry on foreign investment activities in Korea without being subject to any restrictions unless otherwise specifically restricted by the Foreign Investment Promotion Act or other laws or regulations.

Specifically, a foreigner does not face any restrictions in investing in Korea other than in the following circumstances:

- where it interferes with national security or disrupts public order;
- where it causes harm to the health and safety of nationals or is markedly contrary to public morals and decency;  
or
- when it violates Korean laws and regulations.

*Law stated - 12 May 2022*

## Taxation

What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

The principal taxes affecting business enterprises in South Korea include corporate tax, individual income tax, value added tax, customs duty and inhabitant tax levied on corporate tax, income tax and other taxes.

The franchisor has a duty to pay taxes (corporate tax or individual income tax) on royalty income. However, the tax rates are limited to the rates stipulated in the tax treaty between Korea and the state in which the franchisor resides. Meanwhile, the franchisee has a duty to withhold taxes from royalties it pays to the franchisor.

*Law stated - 12 May 2022*

## Labour and employment

## Are there any relevant labour and employment considerations for typical franchisors?

Under the Korean Civil Code, an employer is liable for a tort committed against a third party by an employee who is under the employer's actual direction or supervision, in relation to the performance of a work that is directed or supervised by the employer. Therefore, if a franchisee or its employee is deemed to be an employee of the franchisor, the franchisor may be held liable for damages to a third party caused by the franchisee or the franchisee's employee during the performance of his or her work.

To reduce the risk of such liability, it is advisable for the franchisor not to be involved with the specifics of the franchisee's management and to specify in the franchise agreement that the franchise will be operated by the franchisee as an entity independent from the franchisor. However, since a franchisor and a franchisee are generally independent entities, and therefore the franchisee is not subject to the direction or supervision of the franchisor, it is unlikely that the above liability would be imposed on the franchisor.

*Law stated - 12 May 2022*

## Intellectual property

### How are trademarks and other intellectual property and know-how protected?

Korea is a first-to-file jurisdiction. To obtain reliable protection of trademark rights in Korea, the owner of the trademark should register it with the Korean Intellectual Property Office pursuant to the Trademark Act . During the application period, no protection is provided. However, while the application is pending, the applicant may send a warning letter to any person who uses an identical or similar mark on goods that are identical or similar to the goods for which the application has been filed. If the trademark application subsequently becomes registered, the applicant (now the registrant) may bring a claim against such person for losses accrued from the date the written warning was received by such person up to the registration date of the trademark.

Once the registration is granted, the owner may seek to enforce the trademark rights against third-party infringements by seeking injunctive relief against further infringement, damages or an order for the destruction of the infringing goods.

In addition to the Trademark Act, the Unfair Competition Prevention and Trade Secret Protection Act is available to protect well-known but unregistered trademarks, trade secrets and know-how.

*Law stated - 12 May 2022*

## Real estate

### What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

In the past, the ownership of Korean real estate by foreigners was regulated in two ways: restrictions on title to land under the Alien Land Acquisition Act, and restrictions against leasing real estate (land or building) under the Foreign Investment and Foreign Capital Inducement Act. However, the Alien Land Acquisition Act was substantially amended in 1998 to permit a foreigner to purchase real property located in Korea with a simple report of the acquisition of title to the relevant local government office (this act has been repealed and reporting is now required under the Act on Report on Real Estate Transactions, Etc ). In addition, through amendments to the Foreign Investment and Foreign Capital Inducement Act in 1998, foreign investment in the business of leasing real estate was fully liberalised (the name of this act was changed to the Foreign Investment Promotion Act). In practice, most franchisees lease, rather than own, the

real estate in which they operate their franchised units.

*Law stated - 12 May 2022*

## Competition law

What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The Monopoly Regulation and Fair Trade Act (MRFTA) is the primary competition statute in Korea. The general provisions of the MRFTA apply to regulate the franchise relationship (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets).

*Law stated - 12 May 2022*

## OFFER AND SALE OF FRANCHISES

### Legal definition

What is the legal definition of a franchise?

Under the Fair Transactions in Franchise Business Act (the Franchise Act), a franchise is defined as:

a continuous business relationship in which the franchisor allows the franchisee to sell goods (including raw and auxiliary materials) or services under certain quality standards and business method using its trademarks, service marks, trade name, signs and other business marks (collectively, 'Business Marks'), and supports, educates and controls the franchisee with regard to relevant management and operating activities, and in which the franchisee pays franchise fees to the franchisor in return for the use of the Business Marks and the support and education concerning the management and operating activities.

*Law stated - 12 May 2022*

### Laws and agencies

What laws and government agencies regulate the offer and sale of franchises?

The Franchise Act, which was enacted on 1 November 2002 and most recently amended on 18 May 2021, and which came into effect on 19 November 2021, and its Presidential Decree (most recent amendment effective on 19 November 2021), are the primary statutes applicable to the franchisor–franchisee relationship. Additionally, the Commercial Act, the Monopoly Regulation and Fair Trade Act (MRFTA) and regulations promulgated by the Korea Fair Trade Commission (KFTC) are generally applicable.

The Franchise Act provides that the Act will not be applicable if the total franchise fees paid by the franchisee to the franchisor for a six-month period beginning from the date of initial payment of franchise fees do not exceed 1 million won, or if the annual sales of the franchisor is less than 50 million won. However, where the franchisor has established and operated a directly managed outlet before it begins offering the franchise business for at least one year, the inapplicability threshold for franchisor annual sales under the Franchise Act is 200 million won. However, with the recent amendment to the Franchise Act, these small-scale franchisors are now required to abide by articles 6-2 through 6-5, 7, 9, 10, and 15-2 of the Franchise Act, which generally provides obligations regarding registration of franchise

disclosure documents, deposit of franchise fees, provision of franchise disclosure documents to prospective franchisees, prohibition on providing false or exaggerated information, return of franchise fees under certain conditions, and indemnity insurance contract for franchisees. In other words, the scope of exemptions for small-scale franchisors is significantly reduced.

The KFTC regulates franchises in Korea. The KFTC maintains a franchise-specific department, the Korea Fair Trade Mediation Agency, and has the authority to impose administrative measures against franchisors that engage in unfair activities. In this regard, the KFTC has the discretion to determine the unfairness or reasonableness of the activities of the franchisor, levy penalties, and issue corrective orders against violators depending on the nature and degree of the unfair activity. However, the violator may seek a district court's judicial review of the KFTC's findings.

*Law stated - 12 May 2022*

## Principal requirements

What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The Franchise Act is based on the principle of good faith and fair dealing, and seeks to provide a framework for building a fair and equal business relationship between the parties involved in franchising. The Franchise Act delegates the task of overseeing the Korean franchise industry to the KFTC, and the KFTC in turn provides necessary guidance and order by monitoring and calibrating the industry through corrective measures and penalties for those who violate the Franchise Act.

The Franchise Act is divided into six main chapters.

Chapter I sets the stage by providing the purpose of the Franchise Act and the definitions of various terms used throughout the Franchise Act. Chapter II deals with the basic principles that govern franchise transactions and Chapter III addresses fairness in franchise transactions, which, among other requirements, places registration and disclosure obligations on the franchisor.

Chapter III provides a list of basic, mandatory provisions that need to be included in a franchise agreement. Chapter IV outlines the dispute mediation committee regulated by the KFTC and details the qualifications and the roles of the committee. Chapter IV also defines the roles and responsibilities of 'franchise brokers.'

Chapter V deals with the disposition of cases under the KFTC and stipulates details of the corrective measures that can be instituted, including a provision on administrative fines imposed on a franchisor that violates certain provisions of the Franchise Act. Furthermore, because this chapter makes references to provisions of the MRFTA, a franchisor must also be concerned with the application of the MRFTA. Chapter VI imposes administrative and criminal liabilities and, depending on the nature and degree of the violation, a maximum prison sentence of up to five years or a penalty of not more than 300 million won could be imposed.

*Law stated - 12 May 2022*

## Franchisor eligibility

Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Franchisors who intend to register a disclosure document (ie, companies that intend to start a franchise business) must have at least one year of experience in operating at least one directly managed unit by that franchisor. An affiliate's experience will not be sufficient to satisfy this requirement. However, the Franchise Act provides exceptions

for franchisors who operate franchised business with permission or licence under relevant laws and regulations, franchisors who have at least one year of experience in operating a business in the same industry as the franchised business in or out of Korea, and franchisors whose businesses have been verified by KFTC even if they have no experience in operating directly managed units.

*Law stated - 12 May 2022*

### **Franchisee and supplier selection**

Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

The Franchise Act requires a franchisor to expressly grant a franchisee an exclusive business territory in the franchise agreement. Specifically, the franchisor must define the business territory pursuant to an agreed-upon criterion (eg, geographic scope) and stipulate the business territory in the franchise agreement. During the term of the franchise agreement, the franchisor cannot establish a company-owned, affiliate-owned or franchised unit of the 'same type of business,' which is determined on a case-by-case basis, within the business territory of the franchisee.

The term 'same type of business' means a business that would be considered the same in light of various factors, including the target class, territorial boundary, population boundary, types of products and services sold, and business manner and method.

*Law stated - 12 May 2022*

### **Pre-contractual disclosure – procedures and formalities**

What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

Prior to the amendments to the Franchise Act that occurred in 2007, which came into force in 2008, a franchisor was excused from the obligation to disclose to the prospective franchisees unless the prospective franchisees specifically requested delivery of the disclosure document in writing. However, under the current Franchise Act, a franchisor must make pre-contractual disclosure to enter a franchise relationship. The disclosure procedure is as follows:

- a franchisor must provide a disclosure document even if the franchisee does not specifically request it in writing;
- in providing the disclosure document to a prospective franchisee, a franchisor must register the disclosure document with the KFTC and, thereafter, provide the registered disclosure document to the prospective franchisee; and
- the acceptance of franchise fees or execution of a franchise agreement is prohibited unless the franchisor has provided the registered disclosure document and 14 days (seven days if the prospective franchisee has been advised by counsel or franchise broker) have elapsed from the date of providing the registered disclosure document.

The disclosure document may be delivered to a prospective franchisee by:

- providing the disclosure document (hard copy) directly or sending it by content-certified mail to the prospective franchisee;
- providing the disclosure document via access to the internet; or

- emailing the disclosure document in an electronic file to the prospective franchisee.

Regarding the update of the disclosures, a franchisor must register (or report) any changes in the disclosure document with the KFTC. Depending on the importance of the information that has been changed, deadlines for filing the report thereto range from within 30 days of the occurrence of the cause of the change and within 30 days of the expiration of the quarter in which the cause of the change has occurred. Further, the franchisor has an obligation to update the disclosure document on an annual basis within 120 days of the expiry of each fiscal year.

*Law stated - 12 May 2022*

## **Pre-contractual disclosure – content**

### **What information is the disclosure document required or advised to contain?**

The following broad categories of information are required to be included in the disclosure document:

- information regarding the general status of the franchisor;
- information regarding the current status of the franchisor's franchise (eg, the total number of company-owned and franchised units in operation as at the end of the most recent fiscal year);
- information regarding any legal violation by the franchisor and its executives;
- information regarding the obligations of the franchisee;
- information regarding conditions of and restrictions on the business activities of the franchisee;
- information regarding detailed procedures and the period required in respect of the commencement of the franchised business;
- information regarding support for business activities, and education and training programmes (it must be specified if there is no plan for education and training);
- information regarding the current status of the franchisor's directly managed stores (eg, duration of operation and sales)
- information regarding any mark-ups (prices set higher than reasonable wholesale price) on mandatory purchase items that the franchisee is required or recommended to buy from the franchisor or its designated suppliers;
- information regarding the high-end price and the low-end price of items that are in the top 50 per cent of the items – the 'major items' – sourced to the franchisee by the franchisor or its designated suppliers; and
- information regarding any compensation or economic benefits received by the franchisor or 'specially related entities' of the franchisor by compelling or recommending the franchisee to transact with a designated counterparty (eg, authorised supplier).

In addition to the information contained in the disclosure document, as separate documents, a franchisor must also provide the following:

- information regarding the projected minimum and maximum sales revenue of the franchised unit for a period of one year after commencing operations, including the distance between the franchised units that served as the basis for calculating the sales projection and the prospective franchisee's contemplated franchised unit; and
- information regarding the 10 closest franchised units (eg, contact information, business name and location of the franchised units).

*Law stated - 12 May 2022*

### **Pre-sale disclosure to sub-franchisees**

In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

In a sub-franchising structure, the sub-franchisor must make pre-sale disclosures to sub-franchisees. A franchisor – the master franchisor – need not provide a disclosure document to a sub-franchisee if the franchisor is not in a contractual relationship with the sub-franchisee, which is usually the case. In other words, a franchisor has no obligation to provide a disclosure document if it is not a party to the franchise agreement or any other agreements with a sub-franchisee.

In a disclosure document, there must be a disclosure on the description of the general status of the franchisor. Although neither the Franchise Act nor its Presidential Decree specifically requires that the information concerning the master franchisor (and, further, the information on the contractual or other relationship between the master franchisor and the sub-franchisor) be included in the disclosure document as the information relates to the 'description of general status of the franchisor', depending on the circumstances, it could be appropriate to include a brief summary of such information on the sub-franchising structure in the disclosure document.

*Law stated - 12 May 2022*

### **Due diligence**

What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

For franchisors seeking to offer their concepts in Korea, it is advisable to carry out due diligence on business considerations (eg, types and composition of products or service offerings, import costs, local costs, payments, market trends and, if relevant, political risks), legal and regulatory matters (eg, the legality of selling or offering certain products or services, the validity of trademarks and other intellectual properties, registration and pre-contractual disclosure, and the franchisee's permits, licences or approvals for carrying out the franchise business) and the prospective franchisee (eg, full registered name and address, organisational structure, financial capability, reputation, involvement in past civil, criminal or administrative proceedings, and actual or threatened court or other legal or criminal actions).

*Law stated - 12 May 2022*

### **Failure to disclose – enforcement and remedies**

What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

If there is a violation of any disclosure requirements, the franchisee may report such a violation to the KFTC. Furthermore, the franchisee may bring a lawsuit for damages and cancel or rescind the franchise agreement under general principles of tort or contract law in accordance with the Korean Civil Code. If damages remain that are not recovered by cancelling or rescinding the franchise agreement, the franchisee may additionally be entitled to remaining damages, apart from such cancellation or rescission.

Violations of the Franchise Act may be introduced in a lawsuit for damages as evidence of a party's pattern of conduct

or culpability for conduct, but in general such violations do not have any bearing on the calculation of damages in a civil context. Damages are calculated by the general principles of tort and contract law (proximate causation theory), and there is no specific law or regulation applied to franchise transactions. However, if the franchisor has caused any loss to a franchisee by providing false or exaggerated information, by unreasonably suspending or refusing supply of goods, services or assistance, or by imposing retaliatory measures for the franchisee's application for mediation or cooperation with KFTC, the franchisor may be subject to treble damages.

In connection with criminal penalties, the Franchise Act does not create any private right of action. The franchisee can only report the franchisor's violations to the KFTC. A complaint from the KFTC is required to initiate a public criminal proceeding against franchisors, who may have violated the Franchise Act. Upon receiving a report from the franchisee or investigating on its own initiative, the KFTC may decide to institute a public criminal proceeding depending on the seriousness and clarity of the violation of the franchisor. In addition, the prosecutors may, on their own initiative, request the KFTC to file a complaint. In this case, the KFTC must comply with the request. Once there is a public criminal indictment, the KFTC cannot withdraw the complaint.

In theory, criminal penalties under the Franchise Act for disclosure violations are among the most severe in the Korean business sphere. The most severe penalty is reserved for fraud; provision of false or exaggerated information or omission of important items in a disclosure document required under the Franchise Act carries a penalty of up to five years' imprisonment or a fine of not more than 300 million won. Failure to provide a disclosure document, or execution of a franchise agreement or acceptance of franchise fees within the 14 days (seven days if the prospective franchisee has been advised by counsel or franchise broker) after the delivery of the disclosure document is subject to a possible term of imprisonment of up to two years or a fine of up to 50 million won.

Refusal to comply with the KFTC's orders to provide disclosure, if such orders are given, is also potentially subject to a serious penalty. Where disclosure is not provided, or where the disclosure is later reviewed by the KFTC upon the franchisee's request and found to be insufficient (but not fraudulent), the KFTC may demand that the franchisor provide proper disclosure materials. Failure to do so in the face of the KFTC's corrective order may be subject to up to three years' imprisonment or a fine of up to 100 million won.

In addition, in certain cases of disclosure failures, the KFTC may order the return of the franchise fees received.

The KFTC generally prefers to apply pressure to a party – usually the franchisor, given the purpose of the statute – to correct its behaviour to prevent criminal sanctions from being imposed.

*Law stated - 12 May 2022*

### **Failure to disclose – apportionment of liability**

In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

A master franchisor has no duty to provide a disclosure document if it is not a party to the franchise agreement or any other agreements with a sub-franchisee. In this case, liability for violations of any disclosure requirements is solely attributable to the sub-franchisor.

If individual officers, directors and employees of the franchisor engage in a disclosure violation, they would be exposed to liabilities similar to those of the franchisor. Such individuals may be subject to claims for damages filed by the franchisee or in egregious circumstances may face criminal penalties.

*Law stated - 12 May 2022*

## General legal principles and codes of conduct

In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The general fair trade principles under the MRFTA may affect the offer and sale of franchises. No other rules or regulations and government agency or industry codes other than those of the KFTC may affect the offer and sale of franchises in Korea.

*Law stated - 12 May 2022*

## Fraudulent sale

What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Fraudulent or deceptive practices by a franchisor may constitute fraud as stipulated under the Korean Criminal Code. In the case of a disclosure violation, the franchisee can only report such violation to the KFTC. Thereafter, the KFTC will determine whether to initiate criminal proceedings. In the case of fraudulent or deceptive practices constituting criminal fraud, the franchisee may directly file a criminal complaint with the prosecutors. In addition, the franchisee may file a lawsuit for damages against the franchisor with or without cancelling or rescinding the franchise agreement itself.

*Law stated - 12 May 2022*

## FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

### Franchise relationship laws

What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Fair Transactions in Franchise Business Act (the Franchise Act) regulates the ongoing relationship between a franchisor and its franchisee after the franchise agreement comes into effect. Moreover, the general provisions of the Monopoly Regulation and Fair Trade Act (MRFTA) apply to regulate the franchise relationship (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets).

*Law stated - 12 May 2022*

## Operational compliance

What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Generally, the franchisor includes inspection rights (eg, access to the premises of franchised units) and audit rights (eg, review of the accounts, books and records of the franchisee) in the franchise agreements as the primary mechanisms for ensuring operational compliance and standards. Although not as prevalent, some franchisors also reserve the right to deploy mystery shoppers and, to the extent permitted under Korean privacy laws, install video surveillance as part of

an overall effort to maintain brand uniformity and operational compliance.

*Law stated - 12 May 2022*

### **Amendment of operational terms**

**May the franchisor unilaterally change operational terms and standards during the franchise relationship?**

A franchisor may not unilaterally change operational terms and standards in a way that may be considered disadvantageous to the franchisee as such conduct could be seen as an unfair trade practice under the Franchise Act and, more generally, under the MRFTA.

*Law stated - 12 May 2022*

### **Policy affecting franchise relations**

**Do other government or trade association policies affect the franchise relationship?**

The guidelines provided by the Korea Fair Trade Commission (KFTC) may affect the franchise relationship.

*Law stated - 12 May 2022*

### **Termination by franchisor**

**In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?**

The Franchise Act does not specify grounds for terminating a franchise agreement; it merely provides the procedure that must be observed to terminate a franchise relationship.

To terminate a franchise agreement in accordance with the Franchise Act, a franchisor is required to provide a first notice of breach (which describes the grounds for the breach, requests for a remedy of such breach, and states that failure to remedy will result in termination) to the franchisee. Once the first notice is given, a two-month remedy period begins to run (and the franchisee's obligation to remedy arises). During the remedy period, the franchisor must send a second notice of the same breach to the franchisee. If the franchisee fails to remedy the breach, the franchisor may terminate the franchise agreement at the end of the two-month remedy period.

Meanwhile, the Presidential Decree provides for nine exceptions to the above termination procedure and thereby allows for immediate termination of the franchise agreement by the franchisor. No other grounds for immediate termination are permitted under the Franchise Act. The nine exceptions are:

- a petition for bankruptcy is filed with respect to the franchisee (either by the franchisee or by a third party), the franchisee is adjudicated bankrupt, or rehabilitation or foreclosure proceedings commence against the franchisee;
- a suspension of payment of notes and cheques issued by the franchisee owing to insolvency, etc;
- the franchisee cannot continue with the operation of any franchised unit in the territory owing to an event of force majeure or for significant personal reasons, etc;
- the franchisee receives a court judgment for violation of laws related to the operation of a franchised unit or receives an administrative disposition for violating the applicable laws that clearly damages the reputation and credit of the franchisor and the franchisor has suffered significant harm, including:

- an administrative order requiring the franchisee to remedy the violation;
- an administrative order imposing a penalty surcharge or fine on the franchisee for the violation; or
- an administrative order mandating the suspension of operation of the franchised business;
- the franchisee violates laws or regulations relating to the operation of any franchised unit and receives a cancellation order of qualifications, licences, or approvals or a business suspension order exceeding 15 days or other administrative order that cannot be corrected, provided that this shall not apply where an administrative fine, etc, has been imposed on a franchisee in lieu of such administrative order pursuant to any laws or regulations;
- if, after having remedied the breach of the franchise agreement pursuant to the request from the franchisor, the franchisee subsequently repeats the same breach within a period of one year even if the franchisor has notified the franchisee in the notice requesting a remedy for the first breach that the franchise agreement could be terminated without providing the opportunity to remedy in case of another of the same type of breach after the remedy;
- if the franchisee has been subjected to criminal punishment for an activity relating to the operation of a franchised unit;
- the acts, errors or omissions of the franchisee clearly and imminently threaten public safety or health while operating any franchised unit, and it is difficult for the franchisor to await an administrative order; or
- the franchisee suspends business operations of any franchised unit for seven or more consecutive days without justifiable cause (as determined by the franchisor acting in good faith).

*Law stated - 12 May 2022*

## Termination by franchisee

In what circumstances may a franchisee terminate a franchise relationship?

Under the Franchise Act, no restriction or prior notice is required for the franchisees to terminate their franchise relationships. As a general principle of law, however, the franchisee may terminate the franchise agreements in the case of default by the franchisor. In addition, where the franchise agreement is seen as a 'continuing contract', the franchisee may terminate the franchise agreement based on the grounds that the purpose of the franchise agreement has been frustrated as a result of unforeseeable circumstances. In this regard, the Commercial Act provides that a party to a franchise agreement may terminate the agreement under unavoidable circumstances by providing a prior notice to the other party within a set reasonable period, regardless of the duration stipulated in the franchise agreement.

*Law stated - 12 May 2022*

## Renewal

How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

There are no formal (eg, stamp duty, witnesses) or substantive requirements for renewals of franchise agreements.

*Law stated - 12 May 2022*

## Refusal to renew

May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

The Franchise Act stipulates that if the franchisee requests a renewal between 90 and 180 days prior to the expiry of the franchise agreement, the franchisor may not refuse to renew the franchise agreement without just cause. As exceptions, the franchisor is permitted to refuse renewal of the franchise agreement in the following circumstances:

- the franchisee has failed to perform its payment obligations of franchise fees under the franchise agreement;
- the franchisee has not accepted the terms and conditions of the franchise agreement or business policy that are generally accepted by other franchisees of the franchise network; or
- the franchisee has failed to observe the following important business policies of the franchisor that are deemed necessary for maintaining the franchised business:
  - matters pertaining to the procurement of a store or facility that are necessary for the operation of the franchised business, or acquisition of a licence, permit or approval as required by applicable laws;
  - matters pertaining to the observance of production methods or service methods that are necessary for maintaining the quality of the goods or services for sale; and
  - matters other than those above that are deemed necessary for normal operations of the franchised business as determined by the Presidential Decree to the Franchise Act.

If the franchisee requests a renewal, the notice of refusal stating the reasons for non-renewal must be provided within 15 days of receipt of the renewal request. If the notice of refusal (to the franchisee's request for a renewal) is not provided to the franchisee, or a written notice of non-renewal or change in terms and conditions (for the renewal) is not provided to the franchisee between 90 and 180 days prior to the expiration of the franchise agreement, the franchise agreement will be deemed to have been renewed under the same terms and conditions.

As a cautionary note, even if a franchisee does not request a renewal, a franchisor must provide a written notice of non-renewal of the franchisee (between 90 and 180 days prior to the expiration of the franchise agreement) if the franchisor has no intent or does not wish to renew the franchise agreement. If the franchisor first provided a notice of non-renewal (prior to the franchisee's request for renewal) within the above period, then the franchisee subsequently requests a renewal within the same period (despite the franchisor's notice of non-renewal), the franchisor may not refuse to renew the franchise agreement without just cause. In other words, the franchisor's notice of non-renewal (before the franchisee has made a request for renewal) would realistically work only as a reminder to the franchisee to decide whether to renew the franchise agreement.

The franchisee's right to request a renewal may only be exercised for a total duration of 10 years (including the term of the initial franchise agreement and any renewal terms thereafter) and if 10 years have elapsed, the franchisor may refuse to renew the franchise agreement regardless of its reasons (as long as written notice of non-renewal has been provided).

*Law stated - 12 May 2022*

## Transfer restrictions

May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Because it can be said that the franchisor–franchisee relationship is reciprocal, where both parties are creditors as well as debtors to each other (supply obligation on the one hand and payment obligation on the other hand), the franchisee should receive the consent of the franchisor prior to transferring the franchised business (transfer of its obligation) to a third party. In this regard, the Franchise Act provides that the franchisee must first obtain prior written consent of the franchisor to assign the franchised business. Thus, a franchisor may restrict a franchisee’s ability to transfer its franchised business. The Commercial Act further elaborates on such restrictions and prevents the franchisor from refusing the assignment unless there are extenuating circumstances.

However, unless the parties have specifically agreed not to allow for the transfer of ownership interests in a franchisee, there are no restrictions on the franchisee’s right to transfer ownership interests.

*Law stated - 12 May 2022*

## **Fees**

### **Are there laws or regulations affecting the nature, amount or payment of fees?**

The payment and receipt of certain types of fees are strictly regulated under the Franchise Act. Specifically, the Franchise Act proscribes a franchisor from receiving direct payment of the following from the franchisee:

- any consideration that the franchisee pays to the franchisor for management rights, such as the permission to use the business marks or the support and education for its operating activities, potentially including:
  - application fees;
  - membership fees;
  - franchise fees;
  - education and training fees; or
  - down payments; and
- any consideration that the franchisee pays to the franchisor to secure payment for goods supplied by the franchisor or compensation for damages.

The Franchise Act stipulates that the franchisor must require the franchisee to deposit – in escrow – the two types of fees described above to a Korean financial institution prescribed by the Presidential Decree to the Franchise Act. Thereafter, the franchisor may request payment from the financial institution at the earlier of when the franchisee has commenced operations (eg, opened its franchised unit) or two months from the date of execution of the franchise agreement.

Notwithstanding the above, the franchisor may receive both types of fees directly from the franchisee without depositing the fees with a Korean financial institution if:

- the franchisor subscribes to an insurance policy (with the franchisee as the beneficiary) to cover the franchisee’s risks; or
- the franchisor and the franchisee agree that the franchisor will receive both types of fees after two months from the date of executing the franchise agreement or after the franchisee commences operation (eg, opened its franchised unit), whichever is earlier.

In practice, it is difficult, if not impossible, to find a Korean financial institution that will open an escrow account for the benefit of a foreign franchisor. Further, with regard to taking out insurance, there is only one insurance provider in Korea – the Seoul Guarantee Insurance Company – that will issue an insurance policy. To subscribe, a foreign franchisor

must have a guarantor located in Korea (individual or a business entity) that will guarantee the amount of the insurance policy being purchased.

Given the difficulties in finding a willing Korean financial institution and a suitable guarantor in Korea, foreign franchisors seeking to receive the two types of fees described above directly from the franchisees often choose to defer the payment of those fees until two months have elapsed from the date of executing the franchise agreement or the franchisee commences operation of its franchised unit, whichever occurs earlier.

*Law stated - 12 May 2022*

## **Usury**

**Are there restrictions on the amount of interest that can be charged on overdue payments?**

There are no specific restrictions on the amount of interest that can be charged on overdue payments. However, if the interest is deemed excessive, it can be reduced by the Korean courts if challenged.

*Law stated - 12 May 2022*

## **Foreign exchange controls**

**Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?**

There are no laws or regulations restricting the ability of a franchisee to make payments to a foreign franchisor in the franchisor's domestic currency.

*Law stated - 12 May 2022*

## **Confidentiality covenant enforceability**

**Are confidentiality covenants in franchise agreements enforceable?**

In principle, confidentiality covenants in franchise agreements are enforceable. Also, the Commercial Act provides that a franchisee's confidentiality obligation with respect to the franchisor's trade secrets must survive termination of a franchise agreement.

*Law stated - 12 May 2022*

## **Good-faith obligation**

**Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?**

Apart from the specific rules and regulations applicable to the conduct of a franchisor, the Franchise Act also promulgates a code of best practice. Under the Franchise Act, both parties to a franchise relationship must exercise good faith in the performance of their respective duties in connection with the management and operation of the franchised business.

Specifically, the franchisor's duties defined under the Franchise Act are as follows:

- business planning for the success of the franchised business;

- continuing efforts toward quality control of goods or services and development of sales techniques;
- the installation of unit facilities and supply of goods or services to the franchisee at reasonable prices;
- the education and training of the franchisee and its employees;
- continuing advice and support for the management and operation activities of the franchisee;
- a prohibition against establishing a franchisor's company-owned units or establishing a franchised unit of the same type of business to that of the franchisee's franchised unit within its business territory during the period of the franchise agreement; and
- making efforts to resolve disputes through dialogue and negotiations with the franchisee.

Meanwhile, the franchisee's duties are defined under article 6 of the Franchise Act as follows:

- making efforts to maintain the uniformity of the franchised brand and the good reputation of the franchisor;
- the maintenance of inventory and display of goods in an appropriate manner in accordance with the franchisor's supply plan and consumer demand;
- compliance with appropriate quality standards as presented by the franchisor with regard to goods or services;
- the use of goods and services as provided by the franchisor in the event of failure to stock goods or services that meet the quality standards provided in the preceding point;
- compliance with appropriate standards as presented by the franchisor with regard to the facilities and exterior of the place of business, as well as the means of transport;
- consultation with the franchisor prior to effecting any changes in the goods or services in which it deals or in its operating activities;
- the maintenance and provision of the data necessary for unified business management and sales strategy formulation by the franchisor, including, but not limited to, accounting books on the purchase and sale of goods and services;
- the provision to the officers, employees or agents of the franchisor of access to its place of business for the checking and recording of its business status and the data as set out in the preceding point;
- a prohibition of any change in the location of its place of business or any transfer of franchise management rights without the consent of the franchisor;
- a prohibition of any act engaging in the same line of business as that of franchisor during the period of the franchise agreement;
- a prohibition of the disclosure of sales techniques or trade secrets belonging to the franchisor; and
- notification of any infringement of business marks by a third party to the franchisor if it becomes aware of such infringement, and appropriate cooperation with the franchisor to take necessary measures to prohibit such infringement.

The Franchise Act provides neither criminal penalties nor sanctions for failing to adhere to the above duties applicable to the franchisor and the franchisee. Therefore, we interpret most of these provisions as normative or suggested best practice rather than as mandatory standards.

Some Korean franchise agreements explicitly stipulate that a franchisor and a franchisee shall perform their duties in good faith. Even if there is no explicit provision in the franchise agreement that mandates good faith dealing, however, the implied covenant of good faith and fair dealing under the Korean Civil Act apply to the franchise relationship.

*Law stated - 12 May 2022*

### Franchisees as consumers

Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

In principle, franchisees are deemed to be independent commercial entities, and therefore there are no laws that specifically treat franchisees as consumers for the purposes of consumer protection.

*Law stated - 12 May 2022*

### Language of the agreement

Must disclosure documents and franchise agreements be in the language of your country?

Under the Franchise Act, there are no requirements that the disclosure documents be prepared in Korean. However, because the Franchise Act prescribes that the disclosure documents (that will be provided to the prospective franchisee) be registered with the KFTC, in practice the KFTC requires the disclosure documents to be prepared in Korean.

The Franchise Act does not require that the franchise agreement be written in Korean either. However, it is advisable for foreign franchisors to critically evaluate the English language capabilities of any prospective franchisees and be prepared to offer a Korean translation of franchise agreement if the franchisee does not comprehend English or is not using consultants competent to assist with any language deficiency. In addition, when filing an application for registration of the disclosure document with the KFTC, a copy of the template franchise agreement must be submitted. If the template franchise agreement is in another language, a Korean translation must also be submitted. Therefore, it is necessary to prepare a Korean translation of the template franchise agreement to register the disclosure document.

*Law stated - 12 May 2022*

### Restrictions on franchisees

What types of restrictions are commonly placed on the franchisees in franchise contracts?

The main restrictions on provisions in franchise agreements under the Franchise Act relate to the receipt of certain types of franchise fees, duration and renewal of the franchise agreement, exclusive business territories of each franchised unit and procedures for terminating the franchise agreement. Aside from those, there are no notable restrictions imposed by the Franchise Act on the provisions in franchise contracts.

*Law stated - 12 May 2022*

### Courts and dispute resolution

Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Korean legal system is a civil law system, originally adopting the European civil law system and Japanese legal system. The Korean judiciary system is three-tiered and consists of the Supreme Court (the highest court), the high courts (the intermediate appellate courts) and the regional district courts (the courts of first instance). There are six high courts and 18 district courts, divided into geographical districts.

Alternatively, the parties in dispute may resolve disputes relating to the franchise agreement through mediation or arbitration. In particular, the Franchise Act provides that a franchise transaction dispute mediation committee may mediate matters related to disputes over franchise transactions if requested by the KFTC or by the parties in dispute. The franchisor is free to reject a mediation request. However, if mediation is requested due to an alleged violation of the MRFTA or the Franchise Act, it is advisable for the franchisor to comply with the request because, upon refusal, the franchisor may find itself subject to corrective measures under the Franchise Act.

The Korean Commercial Arbitration Board (KCAB) is the main institution of arbitration in Korea. The KCAB is dedicated to the settlement of commercial disputes as a neutral, unbiased and independent institution for administering and conducting arbitration, conciliation and mediation. Arbitration before the KCAB is an alternative way of producing impartial and fair resolutions to commercial disputes.

*Law stated - 12 May 2022*

### **Governing law**

Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

There are no restrictions on designating a foreign governing law in franchise documents. In fact, Korean courts readily enforce foreign governing laws. But, certain provisions of the Franchise Act (eg, renewal, business territory, cost-contribution on remodeling, termination procedure) are interpreted as mandatory, and thus, even if the franchise contracts are governed by foreign laws, the franchise documents must still comply with such provisions.

*Law stated - 12 May 2022*

### **Arbitration – advantages for franchisors**

What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Unlike litigation before the Korean courts, arbitration awards are not appealable and, therefore, may resolve a dispute through a single proceeding. In addition, because arbitration procedures are not public, important information regarding the franchise transaction may be kept confidential.

However, arbitral proceedings may take longer than adjudication before the court of first instance (in many cases, the dispute practically comes to an end when the judgment of the court of first instance has been given) and, therefore, the dispute could be unnecessarily prolonged.

*Law stated - 12 May 2022*

### **National treatment**

In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Aside from minor differences in connection with the obligation to report real estate acquisitions and the restrictions imposed by the Foreign Investment Promotion Act, foreign franchisors are not treated any differently from domestic franchisors.

## **UPDATE AND TRENDS**

### **Legal and other current developments**

Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

## Jurisdictions

	<b>Australia</b>	Norton Rose Fulbright
	<b>Canada</b>	Lapointe Rosenstein Marchand Melançon LLP
	<b>China</b>	Jones & Co
	<b>Finland</b>	ADVOCARE Law Office
	<b>France</b>	Bersay
	<b>Germany</b>	Taylor Wessing
	<b>India</b>	G&W Legal
	<b>Israel</b>	Gilat Bareket & Co, Reinhold Cohn Group
	<b>Italy</b>	Rödl & Partner
	<b>Japan</b>	Anderson Mōri & Tomotsune
	<b>Malaysia</b>	Wong Jin Nee & Teo
	<b>Mexico</b>	Gonzalez Calvillo SC
	<b>Netherlands</b>	Parker Advocaten
	<b>New Zealand</b>	Stewart Germann Law Office
	<b>Norway</b>	CLP
	<b>South Africa</b>	Spoor & Fisher
	<b>South Korea</b>	Lee & Ko
	<b>Switzerland</b>	Kellerhals Carrard
	<b>Turkey</b>	Özdağıştanlı Ekici Attorney Partnership
	<b>United Kingdom</b>	Ashtons Legal
	<b>USA</b>	Lathrop GPM