FRANCHISING IN CHINA: Judicial and Legislative Update 2005-2006

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INTRODUCTION

This article is a review of recent legislative and administrative developments affecting franchising in China, and a review of some significant trade-mark and franchising cases primarily as decided by China's courts since the coming into force of the new Measures for the Regulation of Commercial Franchises[1] ("New Franchise Measures") in early 2005.

Previously a review of cases would have been difficult if not impossible because there is no case reporting system in China, as there is in common law jurisdictions. But as a growing number of Chinese courts set up their own web sites and post their decisions online, and as Chinese lawyers make increasing use of the internet to post copies of decisions and comments on cases, such a review is now possible.

The reporting of significant franchise cases is not universal however, so the decisions discussed in this article do not reflect a selection of the most significant cases from all such decisions of the Chinese courts, but rather a selection of what is available online. Still the decisions provide significant insight into the thinking of some Chinese courts on franchise and trademark matters.

GROWTH OF FRANCHISING

China continues to grow at a rapid pace. GDP reportedly increased 10.2 % in the first quarter of 2006,[2] and 11.3% in the second quarter.[3] But some have expressed concern that the reform of China's legal system has in fact slowed.[4]

The most recent survey from the China Chain Store and Franchise Association[5] ("CCFA") reported that China had 2,320 franchise systems at the end of 2005, or 10.4 % more than at the same time in the previous year.[6] The average number of outlets per system increased from 57 in 2004 to 73 in 2005.[7]

Still franchising accounts for only 3 % of China's retail sales compared to 40% in the United States.[8] If in the future franchising in China comprises a similar proportion of retail sales as it does in the United States franchising in China has significant growth still ahead of it. There are currently an estimated 16,000 franchised outlets in Shanghai and the number continues to expand each year.[9]

There are some weaknesses in this growth. Two of the best known foreign franchise systems in China, KFC and McDonalds, primarily operate corporate or joint-venture owned locations. McDonalds has just one

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1 Measures for the Regulation of Commercial Franchises, 商业特许经营管理办法 (Shangye Texujingying Guanli Ban Fa), Ministry of Commerce Order No. 25 of 2004, in effect February 1, 2005.
2 Xinhua News Agency, "China's GDP in first quarter grows 10.2%" China View, April 20, 2006.
3 Andrew Browne, "Chinese Economy Surges by 11.3%, Fuelling Concerns," Wall Street Journal, July 19, 2006, p. A8.
4 James M. Rhodes, "Jerome A. Cohen: China's Legal System – Notes from a Luncheon Address," New York City Bar Association, April 5, 2006.
5 中国连锁经营协会 (Zhongguo Lian Suo Jing Ying Xie Hui) http://www.ccfa.org.cn/english/index.jsp .
6 Press Release, "Year Report on Franchise in China released by CCFA," CCFA, 2006-03-28.
7 Id.
8 Zhiqiong June Wang, "The Development of Franchising in China," paper presented to the 20th Annual International Society of Franchising Conference, Palm Springs, California, February 24-26, 2006, p. 3.
9 Dai Qian, "Investors find franchises an easier way to start a business," Shanghai Daily, March 13, 2006.

franchisee, in the city of Tianjin in the north, and of KFC's approximately 1,500 outlets only about 70 are franchised.[10]

The other important concern is that many of the domestic franchise systems in China are still at an early stage of development. The business models are often not fully developed or proven and the franchisors have yet to develop the level of support systems that are the norm in North America. CCFA reports that 30% of domestic franchisors do not have a franchise manual, and 20% do not have an operations manual.[11]

There has also been progress in the institutions to study and teach franchise development methods in China. In 2003 Beijing Normal University established its International Franchise Academy in Zhuhai, in cooperation with Franchise Development Services China Ltd.[12] In March of 2004 the Ministry of Education formally approved "franchise management" as a new undergraduate major.

LAW REFORM

In terms of law reform that is relevant to franchising, the recent National People's Congress meeting held March 8 – 14, 2006[13] in Beijing was a disappointment as a number of laws that had been anticipated were not tabled for approval at the Congress.

Foremost among them was what is known as the proposed "Property Rights Law."[14] China is in the process of developing a civil code comparable to those found in Europe. This proposed law would have consolidated the many laws and regulations currently in force in a coherent and comprehensive treatment of the treatment of property rights in both real estate and personal property, and would apply to state-owned property as well as private property.

China's rapid development has led to one of the widest disparities in income in the world. The primary cause for unrest in China's development has not been the thousands of laid-off workers but the taking of traditional farmland or older city housing for the development of new factories and condominium complexes. Violent clashes have occurred when the compensation offered by the local government administration was considered too low.[15]

If it had been tabled the proposed Property Rights law would have clarified issues regarding title, leasehold rights, and security interests in land and equipment that have relied upon in developing franchise locations in North America and Europe.

Another significant disappointment was the failure of the NPC to consider the proposed Anti-Monopoly Law.[16] This law would be comparable to the competition or antitrust laws in Europe or North America.

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10 Wang, supra note 5, p. 6.
11 CCFA, The 2005 Blue Book Report of Franchising and Chain Performance in China, 2005, http://www.hznet.gov.cn/xxzh/20050414/271105.htm (accessed September 2, 2005) as cited in Wang, supra note 5, p.13-14.
12 Wenxian Liu, Andrew Terry, Albert Kong, Xuesi Wang, Jijian Hou, Zhiqiong Wang, and Aifei Tang, "Innovation in the Booming market for Franchising in China: A Study of the International Franchise Academy, Beijing Normal University, Zuhai Campus," paper presented to the 20th Annual International Society of Franchising Conference, Palm Springs, California, February 24-26, 2006. Further information can be obtained from the web site of the Academy at http;//www.bnuifa.cn or http://www.franchise.com.cn.
13 The Fourth Session of the 10th National People's Congress.
14 物权法 (Wu Quan Fa). It is now reported that it will be presented to the NPC in March, 2007.
15 See for example Jim Yardley, "Farmers Being Moved Aside by China's Real Estate Boom," New York Times, December 8, 2004.
16 反垄断法 (Fan Long Duan Fa). It has now been reported that a draft has been approved by the State Council (Andrew Batson, "Draft of Antitrust Legislation Wins's China Cabinet's Backing," Wall Street Journal, June 8, 2006 and Cary Huang, "Law aimed at tackling monopolies approved," South China Morning Post Online Edition, June 8, 2006; and was discussed at the meeting of the National People's Congress Standing Committee, June 19 -22, 2006, Beijing. For the Standing Committee members' comments on the Draft Antimonopoly Law, see http://www.npc.gov.cn/zgrdw/common/zw.jsp?label=WXZLK&id=350218&pdmc=110106.

China began working on a draft about 10 years ago, and has received input from both the European Union and the American Bar Association.

Finally a draft "Law for personal information protection" has been prepared by a group from the Chinese Academy of Social Sciences and was submitted to the State Council for review early last year.[17] The draft law is based on the European model. Hong Kong SAR has had a privacy law based on the European model since 1996.[18] It did not appear, but it is likely that it will first appear as a set of administrative rules and regulations, as has occurred with the franchise measures.

COURTS AND CIVIL PROCEDURE

One of the central problems of the Chinese judicial system has been the fact that both the judiciary and the procuratorates (similar to a district attorney's office) at each level of the court system are paid out of funds from the equivalent level of local government. This has led to what has been described as "local protectionism" on the part of these officials.

In its latest reform plans the Supreme People's Procuratorate announced the intention to make the local procuratorates financially independent of their respective local governments.[19] Hopefully this will lead to a similar independence for the courts in the near future.

Late in 2005 the Supreme People's Court issued the Second National Foreign-related Commercial and Maritime Trial Work Meeting Minutes[20] intended to provide guidance to judges called upon to rule on their jurisdiction in cases involving foreign parties. Article 126 of China's Contract Law, the law that governs the new Franchise Measures, stipulates that the parties to a foreign related contract may choose the law for the settlement of disputes unless the law provides otherwise.[21]

Generally the minutes take an aggressive approach on the jurisdictional reach of the Chinese courts by providing that Chinese courts may still hear a case even if foreign courts have already accepted or decided the case. On the other hand the minutes introduce a *forum non conveniens* analysis, something not previously seen in Chinese law. Parties may argue that a Chinese court should not hear a case if there is a more appropriate forum in another country.

But the minutes also provide that if a parties' choice of foreign law circumvents mandatory or restrictive provisions of Chinese laws or regulations, or violates Chinese public policy, then the foreign law will not apply. It would appear that attempts to avoid the disclosure requirements or the requirement that a franchisor have operated two locations in China for one year by choosing a foreign law to govern the contract will not be held valid.

INTELLECTUAL PROPERTY

Any foreign franchisor with an interest in the Chinese market will be concerned with the state of intellectual property protection in China. This year the news is mostly good. During the 2006 meeting of

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17 Shi Ting, "Landmark privacy law submitted for review," South China Morning Post Online, January 20, 2005; "China to legislate for protection of personal information" People's Daily Online, January 25, 2005.
18 Personal Data (Privacy) Ordinance, Ch. 486, Hong Kong SAR Ordinances.
19 "Central cash to fund local judicial independence," China Daily, September 29, 2005.
20最高人民法院关于印发<<第二次全国涉外商事海事审判工作会议纪要>>的通知, December 26, 2005.
21合同法（Hetong Fa） adopted at the Second Session of the Ninth National People's Congress on March 15, 1999 and came into force on October 1, 1999; 第一百二十六条 涉外合同的当事人可以选择处理合同争议所使用的法律，但法律另外规定的除外。涉外合同的当事人没有选择的，适用与合同有最密切联系的国家的法律. 在中华人民共和国境内履行的中外合资经营企业合同、中外合作经营企业合同、中外合作勘探开发自然资源合同，适用中华人民共和国法律。

the National People's Congress in March China's Supreme People's Court [22] announced the creation of a special court to prosecute product piracy cases.[23] And the web site of the Supreme People's Court now publishes many (but not all) intellectual property decisions online.[24]

China has its own reasons for improving the enforcement of intellectual property rights. This year's meeting of the NPC endorsed the new five-year plan economic policies of relying on rural development and scientific technology and innovation.[25] The goal is to build an innovation oriented country.

Another reason is that most product piracy in China harms Chinese businesses. Estimates of the percentage of IP infringement cases that involve foreign-related parties range from 5%[26] to 20%.[27]

Conflicts with Business Names

In the western press the leading trademark case in China in the last year was the decision of the Shanghai No. 2 Intermediate People's Court[28] with respect to the trademarks 'STARBUCKS' and '星巴克' (Xing ba ke). It was hailed as encouraging others to feel that China's courts are a place where there is now a chance of getting legal redress.[29] In fact the case is one of several efforts by Starbucks to monitor and protect their brand in China.

In 1998 Starbucks Corporation registered the trade-mark "星巴克," the Chinese characters that it was using to represent its main trademark, "STARBUCKS".[30] Then in 2000 a Chinese company based in Shanghai registered its corporate name as 上海 星巴克 咖啡 公司 (Shanghai Xingbake Coffee Co.) The Shanghai Xingbake company considered the trademarks "STARBUCKS" and "星巴克" to be different from its corporate name. Starbucks Corporation argued that they are the same.

While Starbucks Corporation won the first round, the decision is under appeal. Because it is under appeal the court has released only the order, and not the full judgment. Accordingly the media stories are based on verbal reports and contain errors and contradictions.[31]

There is a problem in China with competing merchants registering businesses incorporating part or all of a well-known trade-mark when starting their business. When challenged by the trade-mark owner they then claim that their use of the name is authorized.

A month and a half before the Shanghai case was decided Starbucks won a similar case in the Qingdao Intermediate People's Court in Shandong Province.[32] The Judge in this case decided that the Chinese

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22 最高人民法院 (zui gao ren min fa yuan) http://www.court.gov.cn/ .

23 Associated Press, "Special Court to enforce intellectual property rules," South China Morning Post Online, Friday, March 10, 2006. The court is to be called the "Judicial Court of Intellectual Property."

24 At http://www.ipr.chinacourt.org . It now has well over 4,000 court decsions.

25 China Daily, "NPC endorses shift in economic policy," CHINAdaily.com.cn, March 15, 2006.

26 The China IP Blog, IP Dragon, in a posting on March 10, 2006 entitled "Judicial Court of Intellectual Property Announced and Supreme People's Court Judge's Surprising Surprise," quoted Supreme Court judge Jiang Zhipei as saying "Some 95 percent of product piracy cases involve violations against Chinese companies, with only about 5 percent stemming from complaints from foreign companies. So it's a strange phenomenon that foreign governments, and some U.S. congressmen, have made very strong complaints about this."

27 Liu Li, "IPR appeals court in the pipeline," China Daily, March 10, 2006. The article states that "Some 20 per cent of IPR disputes in Chinese courts are foreign-related, and in most such cases, foreign parties are plaintiffs."

28 上海市第二中级人民法院 (Shanghai Shi Di Er Zhong Ji Ren Min Fa Yuan) http://www.shezfy.com/main.aspx . The decision was handed down December 31, 2005. As the decision is under appeal the written reasons have not yet been released.

29 "Starbucks wins Chinese logo case," BBC News, January 2, 2006.

30 "星巴克案美方胜 上海星巴克须更名并登报致歉" (Starbucks US wins victory, Shanghai Starbucks must change its name and apologize) Xinhuanet January 4, 2006 (in Chinese).

31 "Starbucks wins dispute over name" Toronto Star, Tuesday, January 3, 2006, p.E2 (incorrectly claiming that the infringer registered its name before Starbucks registered the Chinese version of its trademark). The BBC article, supra note 27, made the same error.

version of the "STARBUCKS" was not a famous mark because it had not been used for a sufficiently long period of time. Still the Chinese mark was registered so the judge wrote:

> 被告是在中国工商机关登记注册的外资公司，经过合法注册的企业名称应当受到法律的保护，但其前提是，该名称为合法取得且不侵害他人的在先权利，当其使用的字号侵犯了他人的在先权利，并容易导致相关公众误认时，被告就不能以合法注册，作为免除其侵权责任的抗辩理由。(Defendant has registered as a foreign invested corporation with Chinese Administration of Industry and Commerce. It is entitled to legal protection only if its' business name has been registered when the prior rights of other are not violated. When the prior rights of others are encroached upon and its business name confuses the public, the defendant is liable and cannot avoid a claim of infringement based on such registration.)[33]

In support of this proposition the judge cited the Supreme People's Court Interpretation on Trademark Disputes promulgated October 12, 2002 and effective October 16, 2002. [34]

As was noted earlier it is not only famous North American corporations that suffer this problem. The Taiwanese owned 上海弘奇食品有限公司 (Shanghai Hong Qi Food Limited) that franchises Chinese style restaurants under the trademark "永和" (YONGHE) recently defended its mark in two other Chinese provinces.[35] And for Chinese franchisors the problem has existed for sometime.[36]

Chinese Versions of Western Marks

There is a problem with all western trademarks in China that arises in part because of the unique characteristics of the Chinese language. Chinese does not have any form of alphabet and uses only about 400 syllables[37] to represent approximately 10,000 characters. This means firstly that a direct phonetic transliteration of a foreign trademark is very rarely possible in Chinese. It also means that a particular sound may be represented by a number of characters, some of which may have entirely unsatisfactory meanings.

Further marks that sound alike to western ears may not be considered confusingly similar to the average Shanghai resident on the Huaihai Road omnibus. For example in China Ikea, the Swedish furniture company, has the Chinese name "宜家" which is transliterated in pinyin as "Yi Jia." Together these characters may be translated as "a proper home." One of its major local competitors has adopted the mark "爱家" which is transliterated as "Ai Jia" and means "love home."

Not only is this apparently tolerated, but one report[38] noted that recently on the opening of a new store Ikea introduced its new slogan "爱的新体验." The companion English version was "MORE TO LOVE" but a literal translation would be something like "a new experience of love."

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32 星源公司 (Starbucks Corporation) v. 青岛星巴克咖啡餐饮有限公司 (Qingdao Star Ba Ke Coffee & Dining Limited), 山东省青岛市中级人民法院 (Shandong Province Qingdao City Intermediate People's Court) November 16, 2005 http://www.qdmc.gov.cn/admin/cpws/html/20061181108107.htm .

33 Translation by author.

34 最高人民法院关于审理商标民事纠纷案件适用法律若干问题的解释 - Interpretations of the Supreme People's Court of Several Issues Concerning the Application of the Law to the Trial of Civil Dispute Cases Involving Trademarks, promulgated October 12, 2002 and effective October 16, 2006.

35 上海弘奇食品有限公司 v. 徐明人， 张桔兰， 江苏省连云港市中级人民法院 November 8, 2005 (Shanghai Hong Qi Food Limited v. Xu Ming Ren and Zhang Jie Lan, Jiangsu Province Lianyungang City Intermediate People's Court) http://www.jsfy.gov.cn/cpws/cpws_read.jsp?id=978 ; 邱雪伟 v. 上海弘奇食品有限公司， 江西省高级人民法院 April 17 2006 (Qiu Xue Wei v. Shanghai Hong Qi Food Limited, Jiangxi Province Higher People's Court) http://ipr.chinacourt.org/public/detail_sfws.php?id=3010 .

36 See for example 山东金色童年有限公司 v. 周华， 山东省临沂市中级人民法院，September 29, 2002 (Shandong Jinse Tongnian Limited v. Zhou Hua, Shandong Province Linyi City Intermediate People's Court) http://www.sdipr.gov.cn/art/2005/07/06/art_3677.html .

37 With the use of tones there are about 1300 distinct syllables available. While there is no agreement on the precise number of syllables used in English, one estimate suggests about 2,750 out of a possible 11,000. See http://www.ling.ucsd.edu/~barker/Syllables/index.txt

38 Dror Poleg, "Bilingual Brands: Love in the time of IKEA" Danwei, May 11, 2006.

The lesson for those wishing to protect their trademark in China is to develop a Chinese character version of the trademark as soon as possible and to register both the English and the Chinese character versions. In the cases discussed earlier Starbucks won in part because it had done this. But many western businesses have not yet developed a Chinese character trademark.

When Ferraro S.p.A., the Italian maker of chocolates, began selling its "FERRERO ROCHER" brand chocolates in China in the 1980's it used the Chinese name "金莎," which is transliterated as "Jin Sha," and which may be translated as "golden name" or "golden place." However it never bothered to register the Chinese trademark in China[39], although it registered the Chinese mark in Taiwan and Hong Kong.

A Chinese dairy company in Jiangsu Province, just north of Shanghai, not only began to use the mark "金莎" and very similar packaging for its chocolates, which tasted decidedly inferior to those of Ferrero, but it also applied to register the mark. Even though Ferrero successfully opposed the application the Chinese company continued to use the mark and customer confusion resulted.

Finally in 2003 Ferrero brought an action[40] against its Chinese competitor under China's Anti-Unfair Competition Law[41] Article 5(2) that prohibits businesses from adopting the packaging or decoration distinctive of well-known goods[42] in Tianjin, a large city that acts as the port for Beijing. In the first hearing in No. 2 Intermediate People's Court Ferrero lost in part because the Court held that the packaging was not particularly well-known as being associated with Ferrero, and the Chinese competitor had heavily marketed its products in China during more than ten years of co-existence and held the larger market share. It ruled that although the packaging is similar, it is not so similar as to cause confusion.

Ferrero appealed to the Higher People's Court in Tianjin. The Court ruled in its favour for four reasons. Citing the adherence of both China and Italy to the Paris Convention[43] the court ruled that in order to determine what is "well-known," reference cannot only be had to the domestic market, but also to the foreign market. Secondly the Court noted that in another action the Chinese company had been unable to prove that it had independently created its packing design, and held that the packaging had been copied from Ferrero's product.

Thirdly the court said:

> 根据诚实信用和公认的商业道德准则，知名商品应当是诚实经营的成果。因此，在法律上不能把使用不正当竞争 手段获取的经营成果，作为产品知名度的评价依据。(Based on the principles of good faith and recognized business ethics, "well-known" status for a product must be achieved through management's own efforts. Therefore unfair competition as specified in law cannot be used as a method for management to achieve "well-known" status for a product.)[44]

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39 Emma Barraclough, "Why patience brings rewards in Asia," Managing Intellectual Property News, May 1, 2006.

40 意大利费列罗公司 (FERRERO S.p.A.) v. 蒙特 莎 （张家港）食品有限公司， 天津市高级人民法院，January 9, 2006 (Italian Fei Lie Luo Company (Ferrero S.p.A.) v. Mengtesha (Zhangjiagang) Food Company Limited, Tianjin City Higher People's Court) http://ipr.chinacourt.org/public/detail_sfws.php?id=658 .

41 反不正当竞争法 (Fan Bu Zheng Dang Jingzheng Fa) adopted at the 3rd Meeting of the Standing Committee of the National People's Congress on Spetember 2, 1993; Promulgated by Order No. 10 of the President of the PRC, and effective as of December 1, 1993.

42 Article 5(2) reads: "经营者不得采用下列不正当手段从事市场交易，损害竞争对手: ...

（二）擅自使用知名商品特有的名称、包装、装潢，或者使用与知名商品近似的名称、包装、装潢，造成和他人的知名商品相混淆，使购买者误认为是该知名商品；(Operators shall not adopt any of the following unfair means to carry on transactions in the market and cause damage to competitors: … (2) using, without authorization, the names, packaging or decoration peculiar to well-known goods or using names, packaging or decoration similar to those of well-known goods so that their goods are confused with the well-known goods of others, causing buyers to mistake them for the goods of others).

43 Paris Convention for the Protection of Industrial Property, made March 20, 1883, as revised at Brussels on December 14, 1900, at Washington on June 2, 1911, at The Hague on November 6, 1925, at London on June 2, 1934, at Lisbon on October 31, 1958, and at Stockholm on July 14, 1967, and as amended on September 28, 1979.

44 Translation by the author.

Accordingly because the Chinese company copied Ferrero's packaging it cannot use its resulting status in China against Ferrero. Finally it cited Article 10bis (2) of the Paris Convention in support of the proposition that Article 5(2) of China's Unfair Competition Law should be read liberally. [45]

Although Ferrero was successful in the end, had it registered its Chinese character trade-mark initially it would have avoided the expense and loss of market share that it has endured.

Contributory Infringement

Another major decision in this area came from the Beijing No. 2 Intermediate People's Court[46] when five international design companies sued the landlord of Beijing's famed 'Silk Street Market' (and the relevant individual tenants of stalls selling counterfeit goods) on the grounds that it had contributed to the infringement of their trademarks by knowingly allowing counterfeit goods to be sold by its tenants. The decisions in favour of the trademark owners were upheld by the Beijing Higher People's Court[47] in mid April of 2006. These decisions are final.

In each of the cases one of the key questions was whether it had been shown that the landlord was aware of the infringement by its tenant and had become liable for such infringement. Article 50 of the Regulations for the Implementation of the Trademark Law[48] provides that it is an infringement if it can be shown that the defendant is "intentionally providing facilities such as storage, transport, mailing, concealing, etc. for the purpose of infringing on another person's exclusive right to use a registered trade-mark."

The Beijing Higher People's Court pointed out that the landlord had provisions in the leases that prohibited the sale of counterfeit goods on pain of termination. The Plaintiffs had in each case first purchased goods from the tenant then had their lawyers courier a letter to the landlord. In the opinion of the court the letter fixed the landlord with knowledge of the infringement.

Specifically the Court stated:

> 但秀水街公司在收到了律师函后，并未及时与律师取得联系，亦未采取任何有效措施制止涉案销售侵犯注册商标专用权的商品的行为，致使原审被告潘祥春仍能在此后一段时间内继续实施销售侵犯路易威登马利蒂公司注册商标专用权的商品的行为，秀水街公司主观上存在故意，客观上为原审被告潘祥春的侵权行为提供了便利，故一审判决对此认定正确。(But after receiving the letter from the lawyer [for Vuitton], the Silk Street Company [the landlord] did not promptly contact the lawyer nor take any effective action to keep it from being involved in the sale of trademark infringing goods, and allowed the defendant Pan Xiang Chun [the tenant] to continue the sales of goods infringing Vuitton's trademark. The Silk Street Company objectively and intentionally abused its authority and assisted Pan Xiang Chun, and therefore the first trial correctly recognized this.)[49]

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45 Article 10bis (2) reads: "Any act of competition contrary to honest practices in industrial or commercial matters constitutes an act of unfair competition."

46 北京市 第二 中级人民法院 (Beijing Shi Di Er Zhong Ji Ren Min Fa Yuan) http://bj2zy.chinacourt.org/ .

47 The five decisions are: 北京秀水街服装市场有限公司 v. 路易威登马利蒂有限公司 (Louis Vuitton) No. 335; 北京秀水街服装市场有限公司 v. 普拉达有限公司 (Prada) No. 333; 北京秀水街服装市场有限公司 v. 香奈儿股份有限公司 (Chanel) No. 334; 北京秀水街服装市场有限公司 v. 古乔古希股份公司 (Gucci) No. 336; 北京秀水街服装市场有限公司 v. 勃贝雷有限公司 (Burberry) No. 337; all on April 18, 2006, 北京市 高级人民法院 (Beijing Shi Gao Ji Ren Min Fa Yuan) http://www.bj148.org/bureau/court/bjgfcon.htm . See also "Silk Street Market Loses Appeal in Trademark Case," China Daily, April 19, 2006.

48 商标法实施条例 (Shang Biao Fa Shishi Tiaoli) promulgated by decree No. 358 of the State Council on August 3, 2002, and effective as of September 15, 2002), Article 50(2) reads:
第五十条有下列行为之一的，属于商标法第五十二条第（五）项所称侵犯注册商标专用权的行为：….
（二）故意为侵犯他人注册商标专用权行为提供仓储、运输、邮寄、隐匿等便利条件的。

49 Translation by the author.

The damages awarded to each of the plaintiffs however were only about $2,500.00 USD. Still the cases show that with careful preparation and presentation of the evidence the courts are willing to enforce the laws to protect trademarks.

FRANCHISING

Laws, Regulations and Guidelines

The New Franchise Measures[50] have now been in effect for over a year. A number of foreign franchisors have expressed concerns about certain aspects of the New Franchise Measures, and in particular the requirement for two outlets to have been operated for at least one year.

The Chinese Ministry of Commerce ("MOFCOM") had said that it would release guidelines in the Fall of 2005, but at the time of writing a draft "Franchise Managerial Standard" was still being reviewed.[51] However the Chinese team that reviewed it described it as very practical and as meeting the needs of China's franchise development.[52]

In March 2006 there was a reprint of a news item on the CCFA web site suggesting that the drafting of the proposed "Commercial Franchise Administration Regulation (Tiao Li)" had been completed and that a draft may make an appearance this year.[53] The news item goes on to suggest that the draft regulation will specify clearly the qualifications required to be a franchisor in China.

And most recently there was a news story on the internet stating that the franchise Tiao Li was under consideration by the State Council.[54] The article goes on to state that the new Tiao Li will contain further specifications regarding the qualifications required of a franchisor and for disclosure to prospective franchisees.

Cases in General

China is a civil law jurisdiction, and the structure of its legal system is modeled on that of Germany. In civil law systems a primary source of law is doctrine[55] rather than cases, and consequently civil law jurisdictions tend not to make decisions in particular cases publicly available.

While this particular aspect of civil law may work in developed legal systems, it has come to be considered an obstacle to the development of the rule of law, transparency and consistency in transitional civil law systems such as the Russian Federation and the People's Republic of China.

Russia is now setting up a single digital network that is supposed to link all courts by the end of 2006 so that internet users will be able to track cases from filing to verdict online.[56] A proposed law has been

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50 Supra note 1.
51 CCFA, "Assessment Meeting on Managerial Standard held successfully in Beijing," Press release, English Version November 14, 2005; Chinese version October 26, 2005.
52 Id., This statement appears in the Chinese version only.
53 "商务部条法司：商业特许经营管理条例年内颁布," (Ministry of Commerce Regulation Department: Commercial Franchise Administration Regulation (Tiao Li) will be Promulgated this Year), March 10, 2006, at http://www.ccfa.org.cn/end.jsp?id=25588 . In Chinese law a "tiao li," while technically still translated as "regulation," has a higher and more formal status than the current "guan li ban fa."
54 中国百姓创业网, "解读特许经营市场法规" (Interpretation of Franchising Regulations) 2006-07-20. In Chinese only).
55 These might be described as learned writings. In a Chinese context an example would be the article by 汪传才 (Wang Chuan Cai), 特许经营合同中不竞争条款研究 (Study of the Non-Compete Provisions of Franchise Agreements) online at www.lawpress.com.cn/newsdetail.cfm?iCntno=2252 . Mr. Wang is an Associate Professor at Jinan University in Shenzhen, in Guangdong Province. The article makes extensive use of American materials and cases, and in particular Peter J. Klarfeld, ed. Covenants Against Competition in Franchise Agreements (Chicago: American Bar Association Forum on Franchising, 1992.
56 Nabi Abdullaev, "Supreme Court Touts Automated Justice," Moscow Times, Tuesday, April 11, 2006. The portal will be http://www.sudrf.ru .

submitted to the Duma that would require judges to publish their verdicts and post them on the internet. As noted earlier China is now posting many intellectual property cases online.[57]

Many courts in China now maintain their own web sites, although there does not appear to be a comprehensive policy behind this development as in Russia. Reports of a number of franchise cases can now be found online on such court web sites. Commentaries on such cases and on specific topics written by Chinese lawyers can now also be found on line.

The next part of this paper discusses some of the cases that are available, many of which were decided since the coming into force of the New Franchise Measures. Although in a civil law system cases do not have value as precedents that bind judges the next time that the same question arises, cases are collected by lawyers in civil law systems. They are submitted to judges along with the evidence for their persuasive value. This is also done in China, and a review of these cases will also provide some insight into what judges consider relevant in franchise disputes in China.

Failure to Disclose

In 黄海燕 (Huang Haiyan) v. 北京汉森 美容有限公司 (Beijing Hansen Cosmetology Limited Co.) decided in Beijing on November 16, 2005[58] the plaintiff, a thirty-two year old woman, entered into the franchise agreement on January 2, 2005. She paid a deposit of 30,000.00 Yuan and a franchise fee of 150,000.00 Yuan (about $3,750.00 USD and $18,700.00 USD respectively) to set up a cosmetics service for men in Chengdu, a large city in Sichuan Province in southwest China. Soon after the franchisee discovered that the trademark to be used was not actually registered, that it was not an international brand as represented and that there were problems with the supply of product that had not been disclosed.

The court noted that the New Franchise Measures required written disclosure of basic information in advance and found the franchisor to have intentionally violated this regulation. The court described the purpose of the required disclosure as follows:

> 该信息披露义务的要旨在于使加盟商能够在掌握了各种信息的程度上作出正确的判断，是决定加盟商能否客观认 识特许经营权及能否公平交易的基础。信息披露的目的在于防止欺诈、促进公众的整体利益和促进投资分析。因此，在特许经营中，特许人违反信息披露义务，也构 成欺诈。(The essence of the duty to disclose is to enable the prospective franchisee to decide whether it understands the business objectives and its rights, and whether the franchise offer is fair. The goal of such disclosure is to prevent fraud and therefore to promote investment analysis and the general public welfare. Therefore in franchising if a franchisor violates the disclosure requirement, this also constitutes fraud.)[59]

Citing Articles 54(2) and 58 of China's Contract Law[60] the court declared the franchise agreement to be therefore lacking in fairness, rescinded the agreement, and ordered the return of the plaintiff's money.

Lack of Qualifications to be a Franchisor

In 北京金安泰经贸有限责任公司 (Beijing Jin'an'tai Economics and Trade Ltd.) v. 北京联通实华信息网络有限责任公司 (Beijing Liantong Shihua Information Network Ltd.) [61] the parties signed a franchise agreement to open an internet café in 2002. Later that year for public policy reasons the government

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57 See supra note 24.
58 北京潮阳区人民法院 (Beijing Chaoyang District People's Court) （2005）朝民初字第 24486 号 (File No.).
59 Translation by author.
60 Supra note 21.
61 钱丽红 (Qian Li Hong), 违反诚实信用原则订立合同给对方造成损失应承担缔约过错责任 (Franchisor Liable for Not Making Agreement in Good Faith and Causing Damage to Franchisee) , posted June 7, 2005 on http://hkfy.chinacourt.org , now no longer available.

stopped accepting or processing applications for such cafes. The franchisee sued for a return of its funds and lost at trial when the court accepted the defense of *force majeure*.

It then appealed and won. The appeal cited Article 9 of China's Contract Law[62] which stipulates that a party making a contract must have the corresponding capacity for civil rights and civil conduct. The franchisor did not have the authorizations necessary for an internet café. The commentator, Qian Li Hong, suggests that this case illustrates that concluding a contract without such authority is a breach of the principle of "good faith," a primary basis of China's Contract Law.

If a company that lacks the qualifications required by the New Franchise Measures to be franchisor enters into a franchise agreement not all courts see it as a breach of the good faith provisions.

In 杨素芳 (Yang Su Fang) and 干裕源 (Gan Yu Yuan) v. 张家麟 (Zhang Jia Lin)[63] the plaintiffs signed a series of contracts with the defendant, a resident of Taiwan, to open two tea shops and to buy their supplies from the defendant in 1999. The defendant supplied both the trademark and the training. The second shop failed and the second plaintiff requested a refund of the fees.

The case was first tried in 2002 and then appealed. Although the contract was described as a "supply contract" both courts came to the conclusion that substance was more important than form, and that this was really a franchise agreement. However the defendant did not have the qualifications required of a franchisor under the previous franchise measures.

Thus the Intermediate People's Court on retrial cited Article 9 of the Contract Law[64] for the proposition that to enter into a contract a party must have the corresponding capacity for civil rights and civil capacity. As the defendant was not qualified to be a franchisor the agreements were invalid.

In China there are also restrictions on foreign investors as to the types of industries that they can enter. Previously the distribution sector was restricted and foreign invested enterprises were not allowed to enter a sector where China considered its domestic players to be weak. Until December 11, 2004 franchising was restricted to domestic enterprises.

This restriction was key to the decision in 韩美艳 (Han Meiyan) v. 北京印气巴谊印气健美有限公司 (Beijing Yinqi Bayi Yinqi Jianmei Limited).65 The plaintiff franchisee entered into a franchise agreement with the defendant on July 2, 2004 to operate a cosmetics store under their brand and paid the initial fee of 100,000 Yuan (about $12, 485.00 USD), and agreed to pay a further 641,250 Yuan (about $80, 063.00 USD) for equipment later in two installments. When the further payments were not made, the lawyer for the franchisor defendant sent the plaintiff a letter terminating the contract for non-payment and advising that the initial payment already made would be retained.

The franchisor defendant was incorporated on February 18, 2003 as a wholly foreign-owned enterprise66 ("WFOE") to operate a business in the health sector providing cosmetology services, and to provide skill training and management services. The trademark was not registered until March 28, 2005. But at the time

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62 Supra note 21.

63 广东省佛山市中级人民法院 (Guangdong Province Foshan City Intermediate People's Court) No. 15, April 22, 2005, available at: http://www.fszjfy.gov.cn/shownews.asp?newsid=8591 .

64 Article 9 states: 当事人订立合同，应当具有相应的民事权利能力和民事行为能力。当事人依法可以委托代理人订立合同 (The parties shall, when making a contract, have corresponding capacity for civil rights and civil conduct. A party may, in accordance with the law, entrust an agent to make a contract).

65 北京市朝阳区人民法院 (Beijing Chaoyang District People's Court) No. 5967, August 16, 2005, available at: http://www.lawyer3721.net/index.php3?file=detail.php3&kdir=1657 .

66 The decision describes the enterprise as a 外商独资经营 or "foreign sole-ownership management" enterprise rather than "外资企业" or "wholly foreign-owned Enterprise." The principals of the franchisor were from South Korea.

of the decision it still did not have the approval of the authorities to be engaged in franchising. As was mentioned earlier franchising was not even opened to WFOEs until December 11, 2004.[67]

As the Court in this case stated:

> 根据国务院《指导外商投资方向规定》及其批准的《外商投资产业指导目录》，特许经营属于中国逐步开放的产业，列为限制类外 商投资项目，并明确于 2004 年 12 月 11 日后允许外商投资。也就是说，在 2004 年 12 月 11 日之前，国家不允许外商投资企业以特许经营方式从事商业活 动。
> (According to the "Regulations regarding Foreign Entity Investment in Industry" of the State Council and the "Catalogue Guiding Foreign Investment in Industry," franchising is one of the industries that China gradually opens up, and it was listed as 'restricted.' It is clear that foreign investment is permitted after December 11, 2004. In other words, before December 11, 2004 China did not permit foreign invested entities to be engaged in franchising.[68]

Accordingly the Court found that the franchisor had violated these requirements. Based on Article 52(5) of the Contract Law[69] and Article 10 of the Interpretations of the Supreme People's Court of Certain Issues concerning the Application of the Contract Law[70] the franchise agreement was held invalid and the money was ordered returned to the plaintiff franchisee.

A lawyer in Beijing[71] had predicted in 2005 that the courts would find that WFOEs could not legally be engaged in franchising in China until after December 11, 2004, [72]as the court found in this case. His articles on this topic have been posted in several places on the internet. He identifies this case as the first decision on this issue.[73]

More recently he has gone further and suggested that a foreign franchisor awarding a master franchise directly to a Chinese registered corporation, without going through a foreign invested enterprise ("FIE"), may be in breach of the New Franchise Measures as well as the laws regulating foreign investment.[74] His reasoning is that if the foreign investment laws previously restricted foreign investment in franchising, as the Beijing Chaoyang District People's Court has found, then it is illegal to now do so other than through an FIE that complies with the laws and regulations. In other words foreign investment laws and regulations

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67 See 外商投资商业领域管理办法 (Waishang Touzi Lingyu Guanli Ban Fa – Administrative Measures on Foreign Investment in Commercial Sectors), approved April 16, 2004, Ministry of Commerce Regulation No. 8, 2004. This was to fulfill part of China's commitment to remove restrictions on entry to markets within three years of entry into the WTO. The third anniversary of such entry was December 11, 2004.
68 Translation by author.

69*Supra* note 21. 第五十二条　有下列情形之一的，合同无效：….（五）违反法律、行政法规的强制性规定。(A contract is invalid under any of the following circumstances: … (5) mandatory provisions of laws and administrative regulations are violated).
70最高人民法院关于适用《中华人民共和国合同法》若干问题的解释（一）（中英文对照）(Interpretations The Supreme People's Court of Certain Issues concerning The Application of The Contract Law of The People's Republic of China(Part One) adopted at the 1090th Session of the Adjudication Committee of the Supreme People"s Court on December 1, 1999, and effective as of December 29,1999): 第十条 当事人超越经营范围订立合同，人民法院不因此认定合同无效。但违反国家限制经营、特许经营以及法律, 行政法规禁止经营规定的除外。(Article 10 Where the parties entered into a contract the subject matter of which was outside their scope of business, the People's Court shall not invalidate the contract on such ground, except where conclusion of the contract was in violation of state restriction concerning, or licensing requirement for, a particular business sector, or in violation of any law or administrative regulation prohibiting the parties from participation in a particular business sector).
71 林晓， 北京博融律师事务所 (Lin Xiao, Bejing Borong Law Office).
72 See 林晓，"特许连锁系统的崩溃——当前特许经营合同无效化的危机," (Lin Xiao, Franchise Systems Collapse – The Crisis Arising out of the Invalidity of Current Franchise Agreements) available on line at http://www.law-lib.com/lw/lw_view.asp?n0=4107 .
73 林晓，"述评：外资违法违规从事特许经营第一案判决 " (Commentary: First Decision Holding a WFOE Engaging in Franchising to Be Illegal) available at: http://www.law-lib.com/lw/lw_view.asp?n0=5818 .
74 林晓，当前国际特许面临的法律问题，(Lin Xiao, Current International Franchise Practices Face Legal Test) available at: http://www.law-lib.com/lw/lw_view.asp?no=5861 .

should govern whether or not the grant of a master franchise to a Chinese corporation constitutes a foreign investment.

In contrast to this line of cases, previously the failure to comply with the relevant franchise measures did not completely invalidate the franchise agreement.

In 杭州曼其服饰有限公司 (Hangzhou Graceful It Clothing Limited) v. 国家工商行政管理总局商标评审委员会 (State Administration for Industry and Commerce, Trademark Office, Appraisal Committee) and 深圳市曼其投资发展有限公司 (Shenzhen Graceful It Investment Development Limited)[75] the Beijing No. 1 Intermediate People's Court had to deal with this issue in respect of the previous Franchise Measures (the "Old Franchise Measures").[76]

The Shenzhen company, the third party, was registered on June 30, 1994. On September 16, 1999 it entered into a franchise agreement with Qi Wenrong, the legal representative of the Plaintiff, the Hangzhou company. Qi Wenrong then registered the Plaintiff company on October 13, 1999.

The Plaintiff then registered the trademark "曼其" for use with respect to clothing by an application made December 25, 2000 and approved and registered on February 28, 2002. On April 12, 2002 the third party (the Shenzhen company) objected to the registration and requested its cancellation.

The Trademark Appraisal Committee ruled on June 15, 2005 that the Plaintiff's registration should be struck out, in part because the registration violated Article 15 of the Trademark Law that prohibits agents or distributors from registering the trademarks of their principals without proper authorization.[77]

The Plaintiff appealed this decision. On appeal it argued that the franchise agreement signed on October 13, 1999 between the Shenzhen company and the Plaintiff's principal, Qi Wenrong, was invalid because it was not made in compliance with the 1997 Franchise Measures for Trial Implementation. Under Article 52(5) of the Contract Law this makes the franchise agreement invalid. Therefore the Plaintiff was not the agent or distributor of the Shenzhen company, and could register the trade-mark in its own name under China's first-to-register system.

The court did not accept this argument, and added that it was clear from the evidence that the Shenzhen company was already using the mark. Thus the application by the Plaintiff was also in violation of Article 31 of the Trademark Law.

Non-Payment of Royalties and Penalty Clauses

The autonomy of the parties to make their own contract is something relatively new to China, but the courts do respect that right. In 上海金鹰广告公司 (Shanghai Golden Eagle Advertising Company) v. 俞晓东 (Yu Xiao Dong)[78] the parties entered into a franchise agreement for the development service for four brands to run from November 16, 2000 to October 31, 2003. The royalty was 40,000 Yuan per year (about $5,000.00 USD) payable in quarterly installments. If the franchisee breached the agreement the franchisee had to pay the franchisor a penalty of two year's royalties or 80,000.00 Yuan.

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75 北京市第一中级人民法院 (Beijing City No. 1 Intermediate People's Court) No. 727 (Administrative Judgment), December 12, 2005.

76商业特许经营管理办法（试行）(Shangye Texujingying Guanli Ban Fa (Shi Xing)) - Measures for Administration of Commercial Franchise (Trial Implementation [or Proposed]) promulgated by the former Ministry of Internal Trade on 14 November, 1997.

77 商标法 -第十五条 未经授权，代理人或者代表人以自己的名义将被代理人或者被代表人的商标进行注册，被代理人或者被代表人提出异议的，不予注册并禁止使用。 (Trademark Law – Article 15 Where an agent or representative, without authorization of the client, seeks to register in its own name the client's trademark and the client objects, the trademark shall not be registered and its use shall be prohibited).

78上海市浦东新区人民法院 (Shanghai Pudong New Development Area People's Court) No. 1, May 18, 2005, available at: http://feilan.com/showarticle.asp?id=1492 .

The plaintiff fulfilled its obligations but the defendant fell behind in the payment of royalties. On June 25, 2002 they agreed to terminate the franchise agreement, but the defendant still owed 25,000.00 Yuan. When the defendant sought to avoid payment of the balance, the parties ended up in a series of trials.

With respect to royalties owed the Shanghai Pudong Court stated that:

> 本院认为，原审 原、被告之间签订的“特许加盟经营协议书”并未违反法律强制性规定，应当确认有效，双方均应依约严格履行。之后签订的“终止特许加盟协议”亦系双方真实意 思表示，该协议明确于 2002 年 6 月 25 日终止“特许加盟经营协议书”，故原审被告应当支付截至该日的相应经营使用费。(This Court is of the opinion that the Franchise Agreement is valid if both parties signed the Franchise Agreement and its provisions do not violate the mandatory provisions of any laws, and accordingly both sides should perform strictly as agreed. The parties both having later signed the Franchise Termination Agreement it is clear that the Franchise Agreement was terminated on June 25, 2002, and that therefore the defendant must pay the royalties up to this date).[79]

However the court thought that although the penalty clause was valid, a penalty of 80,000 Yuan on a debt of 25,000 Yuan was excessive, and reduced it to 15,000 Yuan.

In the Fall of 2003 a case was decided where the franchisee claimed that it had not received all the support that it was entitled to. In 北京便宜坊烤鸭集团有限公司 (Beijing Pian Yi Fang Roast Duck Limited) v. 北京龙成科工贸公司 (Beijing Long Cheng Ke Gong Mao Company)[80] the parties entered into an agreement on June 16, 2000 to set up a restaurant and operate it for five years. The royalty was 120,000 Yuan in the first year, and increased 5% each year thereafter. The agreement also provided for a 5% per day additional penalty for late payments.

The restaurant was set up but the defendants were continually behind in their royalty payments, so the plaintiff sued. The defendants countersued that the plaintiff had not fulfilled certain obligations with respect to the trademark and such failure had caused them heavy losses.

The court held that the two defendants had not provided sufficient evidence to prove their objections with respect to the trademark, nor to disprove the plaintiff's contention that the defendants had not provided the required co-operation to complete the trademark procedures. They therefore had to pay damages and interest.

However the court concluded that because the penalty for delayed payment was far higher than the legal standard the provision was invalid.[81]

Yonghe Statement of Claim

Finally on June 6, 2005 a suit was filed by a franchisee against 上海永和大王餐饮有限公司 (Shanghai Yonghe Big King Dining Company Limited) and a management consulting company in Shanghai No. 1 Intermediate People's Court and posted online, presumably by the franchisees' lawyer.[82] The franchisor is well-known in China and is related to a Taiwanese parent company. It has a trade dress similar to KFC but has a menu featuring Chinese cuisine.

The franchise agreement was signed on February 10, 2003 to open another location in Shanghai and pays a franchise fee of 620,000.00 Yuan (about $77,360.00 USD). It is alleged that the franchisor was responsible

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79 Translation by the author.
80北京市第二中级人民法院 (Beijing City No. 2 Intermediate People's Court) No. 3409, September 19, 2003, available at: http://www.pp168.com/news/2005/11-4/13499-3.html .
81 The Supreme People's Court issues 'guidelines' to the courts regarding penalty standards.
82 上海永和大王餐饮有限公司 (Shanghai Yonghe Big King Dining Company Limited) Civil Indictment (Statement of Claim) posted at www.fclaw.com.cn/na.asp?id=668&title=特许经营纠纷 .

for choosing the location and therefore responsible for the losses that at May 31, 2005 totaled 668,513.12 Yuan. The franchisee sent out a letter terminating the agreement and requesting compensation.

The pleadings argue that before December 11, 2004 a foreign-invested enterprise ('FIE") could not franchise in China because it was not a permitted activity; but after December 11, 2004 an FIE could franchise provided that franchising was approved as part of its activities. Accordingly at the time when the franchise agreement was signed, the franchisor did not have the civil capacity, as was successfully argued in the case mentioned previously. The pleadings specifically cite the Supreme People's Court's commentary on interpreting the Contract Law[83].

Secondly the pleadings argue that because the franchisor does not have certain registered trademarks, as required by the previous Franchise Measures and the new ones, the franchisor has violated Articles 40, 42 and 48 of the Contract Law[84]. Article 42 imposes liability for a pre-contractual duty of good faith and requires disclosure of key facts.[85]

Finally it is argued that the franchise agreement violates the fairness principle of the Contract Law because the franchisee owns the assets but the franchisor stipulates the method of operation, and because a royalty is charged for a license to use a trademark that is not registered.

CONCLUSION

One of the more notable aspects of this paper is simply that there are now sufficient cases easily available that it could be written. For both Chinese and foreigners alike the Chinese legal system is becoming more transparent.

The review of the trademark cases suggests that Chinese courts will enforce trademark rights when they are presented with the appropriate evidence. It suggests that notwithstanding China's reputation for counterfeits and piracy, intellectual property rights can be protected if an effort is made on the part of the owner to secure and enforce them.

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83 Supra note 70.

84 Supra note 21.

85第四十二条　当事人在订立合同过程中有下列情形之一，给对方造成损失的，应当承担损害赔偿责任：　（一）假借订立合同，恶意进行磋商；　（二）故意隐瞒与订立合同有关的重要事实或者提供虚假情况；　（三）有其他违背诚实信用原则的行为. (Article 42: In the making of a contract, the party that falls under any of the following circumstances, causing thus loss to the other party, shall hold the liability for the loss. (1) engaging in consultation with malicious intention in name of making a contract; (2) concealing intentionally key facts related to the making of a contract;(3) taking any other act contrary to the principle of good faith.) In Québec and Germany such provisions have been interpreted as requiring a form of pre-contractual disclosure of material facts. In Québec see Cadieux c. St-A. Photo Corporation, Cour supérieure 500-05-006829-947 (le 9 avril 1997) « La bonne foi est le fondement de toute relation contractuelle. Elle doit gouverner la conduite des parties…La réticence ou l'omission de lui révéler la réalité entournant le studio a vicié le consentement donné: ce motif justifie l'annulation du contract de franchise et le remboursement des sommes versées. » (Good faith is the basis of all contractual relations. It should govern the conduct of the parties…The hesitation or omission of the defendant [franchisor] to reveal the reality regarding the studio vitiated the consent given: this justifies the annulment of the franchise agreement and the reimbursement of payments made.) In Germany see Landgericht Kaiserslautern – Aktenzeichen 4 O 607/00, 26 Mai 2004 „Die Klägerin hat aus dem Gesichtspunkt der culpa in contrahendo wegen Verletzung vorvertraglicher Aufklärungs- und Informations- pflichten einen Anspruch gegen die Beklagte auf Schadensersatz. Der Franchisegeber hat bei Verhandlungen über den Abschluss eines Vertrages die Verpflichtung, den anderen Teil über Umstände aufzuklären, die zur Vereitelung des Vertrages zweckgeeignet sind und für die Entschließung des anderen Teils von wesentlicher Bedeutung sind (vgl. OLG Rostock 1996, 13 ff. m. w. N.). Zu solchen Umständen gehören, ohne dass es weiterer Begründung bedarf, insbesondere Angaben über die Gewinnerwartung und Rentabilitätsberechnung." (The Plaintiff has a claim against the Defendant based on the doctrine of culpa in contrahendo because of its breach of its pre-contractual duty to provide education and information, which breach gives rise to compensation. Before concluding a contract the Franchisor has an obligation to explain to the other party facts that would thwart the purpose of the contract and that are of substantial importance to the other party in the resolution of the negotiations (see Rostock 1996, ff. m.w.N.). Such circumstances include particularly, without further justification, information regarding expected profits and financial feasibility.) Translations by the author.

The review of the franchise cases raises new questions for foreign franchisors about the validity of franchise agreements entered into before December 11, 2004 that may cause considerable concern. It also raises questions about the method of entry for a foreign franchisor under the New Franchise Measures. It would appear that the prudent way for a foreign franchisor to enter the Chinese market is to set-up a WFOE that is registered to conduct franchising activities. In this regard it will be necessary to monitor the development of further Chinese cases and regulations on the subject of foreign entry into franchising, including the Yong He case.

It would be useful to have further commentary from Chinese qualified lawyers on this topic. A recent news item quoting a Beijing lawyer suggests that the forthcoming Tiao Li will specify that foreign franchisors that require the payment of funds outside of China will have to register with the government and evidence the operation of two successful units in China.[86]

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86 Supra note 54, "特许经营企业必须到当地 经贸管理部门办理备案登记，境外企业或跨境交付的特许企业必须到国家主管部门申请备案，并提交在境外有两个以上成功运营店铺的资料."