January 2, 2024

KFTC'S ADMINISTRATIVE PRE-ANNOUNCEMENT OF THE DRAFT REVIEW GUIDELINES FOR UNFAIR TRADE PRACTICES IN THE FRANCHISE BUSINESS SECTOR

The Korea Fair Trade Commission ("**KFTC**") has announced Draft Review Guidelines for Unfair Trade Practices in the Franchise Business Sector ("**Draft Guidelines**") in relation to the enforcement of Korea's Fair Transactions in Franchise Business Act ("**Franchise Act**"). The administrative pre-announcement of the Draft Guidelines will run from December 29, 2023 to January 18, 2024.

I. KEY EXAMPLES OF UNFAIR TRADE PRACTICES IN THE DRAFT GUIDELINES

The Draft Guidelines are intended to assist KFTC case handlers in assessing the unlawfulness of unfair trade practices and to provide franchisors with guidance to prevent in advance violations of the Franchise Act. Some of the key examples of unfair trade practices included in the Draft Guidelines are as follows:

A. Unfairly Refusing to Renew Agreements

1. Refusing to renew the franchise agreement based on the franchisee's opposition to the franchisor's plan to establish a new store within the franchisee's business territory, either operated directly by the franchisor or by another franchisee.
2. Refusing to renew the franchise agreement based on the franchisee's non-compliance with the franchisor's business policies, as the franchisee raised issues with the franchisor's increase of raw material prices.

B. Restricting Franchisees' Counterparties

1. Forcing the franchisee to exclusively purchase products and services, not deemed essential for conducting a franchise business, from the franchisor or an entity designated by the franchisor. Examples of such products and services include:
   - General consumer goods that are not directly related to maintaining the consistent quality of the franchise's core products and are not visible to consumers (for example, disinfectants, kitchen detergents, equipment cleaners, sanitary products, cleaning supplies, and office supplies in a food service franchise business).
   - Equipment and facilities that are not directly related to maintaining the consistent quality of the franchise's core products (for example, terrace chairs, smoking room chairs, paging systems, air conditioners, cash registers, and computer equipment in a food service franchise business).
   - Services not directly related to maintaining the consistent quality of the franchise's core products (for example, pest control services and automated security services in a food service franchise business).

2. Forcing the franchisee to exclusively purchase certain products and services from the franchisor or an entity designated by the franchisor, despite the fact that allowing the franchisee to freely select its suppliers based on the quality standards suggested by the franchisor is sufficient to maintain the franchise's unified image and consistent product quality. Examples of such products and services include:

    - Products that are unlikely to be considered specially ordered or produced by the franchisor, or supplementary materials readily available in the market that are unlikely to be regarded as materials for which the franchisor needs to manage distribution or hygiene to maintain consistent quality (for example, pepper, salt, soy sauce, and ketchup in a food service franchise business).
    - Common tools with the same functionality, readily available in the market (for example, scissors, knives, cutting boards, ladles, baskets, scales, timers, seasoning containers, thermometers, and sanitary gloves in a food service franchise business).
    - General disposable items with identical or similar functionalities, readily available in the market, even if the items come with business logos or special designs (for example, soup containers, side dish containers, straws, and napkins in a food service franchise business).
    - Equipment with the same functionality, readily available in the market (for example, refrigerators, fryers, ovens, and coffee machines in a food service franchise business).

C. Forcing Purchases

Forcing the franchisee to purchase raw or supplementary materials in excess of the amount necessary, by requiring each order to exceed a specific minimum volume or price without reasonable grounds.

D. Unfairly Forcing Franchisees

Forcing the franchisee to bear the additional cost of discounts offered as part of the franchisor's promotional activities, initially agreed to be covered by the franchisor, without reasonable grounds.

E. Setting or Imposing Excessive Penalties

Imposing a penalty amount that is excessively high compared to the actual loss incurred, without considering the remaining period of the agreement, when the franchisee unilaterally terminates the agreement during its term.

F. Unfairly Forcing Franchisees to Improve Store Environment

1. Requiring all franchisees to undertake store environment improvements when the franchisor introduces a new interior model, without considering the age or condition of the stores, and forcing compliance by requiring the franchisees to provide a statement of confirmation indicating their acceptance of any measures taken by the franchisor in case of failure to comply by a specified deadline.

2. Imposing store environment improvements as a condition for approving the transfer of business, even in cases where the franchise store has only been open for two years and cannot objectively be considered aged or have hygiene or safety defects.

3. Requiring the franchisee to improve the store environment without reasonable grounds and periodically inspecting its compliance, while pressuring the franchisee to comply by making compliance a condition for the renewal of the agreement.

4. Establishing a store environment improvement plan and continuously urging or requiring the franchisee to implement it, but not paying the legally required costs based on voluntary store improvement requests the franchisor obtained from the franchisee, presumably to avoid the burden of the costs.

G. Unreasonably Restricting the Franchisees' Business Hours

Not permitting the franchisee to reduce its business hours, despite the franchisee's request to the franchisor based on the objectively evident fact that the sales revenue would not cover operational costs, such as labor expenses, during late-night hours, due to the lack of foot traffic considering the location of the franchise store.

H. Infringing on Franchisees' Business Territory

1. Changing the business territory of the franchisee in the course of renewing the franchise agreement, despite the lack of reasonable basis such as significant changes in the commercial district where the franchisee's store is located.

2. Establishing a directly-operated store within a 500-meter radius of the franchisee's existing store without reasonable grounds, despite the franchise agreement explicitly stating that no new franchise store, operated either by another franchisee or directly by the franchisor, can be established within a 1 km radius of the franchisee's store.

3. Relocating a franchise store that the franchisor has acquired into the business territory of the franchisee without reasonable grounds.

I. Taking Retaliatory Measures

Refusing to renew or terminating the agreement with the franchisee because the franchisee reported the franchisor's Franchise Act violations to the KFTC.

J. Violating the Obligation to Agree on Advertising and Promotional Events

1. Proceeding with a nationwide TV advertising campaign and billing the cost to all franchisees, even though less than 50% of the total franchisees agreed to such advertising campaign.

2. Requiring all franchisees to participate in a promotional event offering discounts for a new product and making them bear a portion of the discount cost, even though less than 70% of the franchisees agreed to such promotion.

3. Simultaneously entering into agreements for multiple advertising and promotional campaigns without specifying the details and the burden of cost for each individual event, but documenting them in a generalized manner and collectively concluding the agreements.

K. Interfering with Franchisee Association's Activities

Conducting store inspections that are excessive compared to ordinary inspections for the store of the franchisee who led the establishment of the association, and refusing to renew or terminating the agreement with the franchisee, citing violations identified through such inspections.

In particular, the KFTC has specified cases relating to mobile gift vouchers, which have recently become an issue, that may constitute a violation of the Franchise Act. These cases include the violation of the obligation to agree on advertising and promotional events with the franchisees (Article 12-6, Paragraph 1) or abuse of superior bargaining position (Article 12, Paragraph 1, Subparagraph 3), as follows:

A. Violation of the Obligation to Agree on Advertising and Promotional Events with Franchisees (Article 12-6, Paragraph 1)

1. Issuing mobile gift vouchers of a promotional nature without first entering into an agreement with the franchisees or obtaining their consent.

2. Requiring all franchisees to accept mobile gift vouchers of a promotional nature, even though less than 70% of the total franchisees have agreed to the issuance of such vouchers.

3. Entering into agreements with franchisees to accept mobile gift vouchers of a promotional nature without including in the agreement the details of the franchisees' cost-sharing ratio (for example, the ratio for sharing the commission for using mobile gift vouchers, or the cost-sharing of the difference between the face value of gift vouchers exchanged for a product and the actual sales price of the same product).

B. Abuse of Superior Bargaining Position (Article 12, Paragraph 1, Subparagraph 3)

1. Forcing franchisees to accept mobile gift vouchers without their consent and forcing them to unilaterally bear related costs such as commissions.

2. In the event the price of a product increases after mobile gift vouchers exchanged for the product have been issued, resulting in a difference between the face value of the gift vouchers and the actual sales price of the product, making the franchisees solely bear this difference without reasonable grounds.

3. Causing harm to franchisees by not settling the payment for the sales made by using mobile gift vouchers within the previously agreed-upon period without reasonable grounds, such as delays in payment by the gift voucher issuing company.

II. CONCLUSION

With the implementation of the Draft Guidelines, the KFTC is highly likely to use them as a basis for investigating and sanctioning franchisors. Recently, the KFTC announced plans to conduct ex-officio investigations in 2024, particularly focusing on private equity-owned franchisors and their practices of transferring various costs to franchisees, and to take strict measures against violations uncovered in the process. In light of these developments, we recommend that franchisors conduct internal compliance reviews, considering the details and implications of the Draft Guidelines.

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