January 31, 2025

KFTC AMENDS STANDARD FRANCHISE AGREEMENTS AND PLANS TO CONDUCT COMPLIANCE REVIEWS OF FRANCHISORS

The Korea Fair Trade Commission ("KFTC") announced on December 30, 2024, that it has amended its standard franchise agreements across 13 business sectors[1] to address unfair trade practices in franchise businesses and reflect recent regulatory developments. In addition, the KFTC recently stated that, starting from February 3, 2025, it will conduct compliance reviews of 75 major franchisors to check whether the requirements regarding mandatory purchase items have been properly reflected in their franchise agreements.

The KFTC provides standard franchise agreements tailored to various business sectors, incorporating Korea's franchise regulations and the specific characteristics of each sector. These standard agreements are designed to help businesses minimize legal violations and streamline the drafting process while also serving as practical guidelines when the KFTC conducts compliance reviews under the Fair Transactions in Franchise Business Act (the "Franchise Act"). The KFTC actively promotes the adoption of these standard franchise agreements by offering incentives to franchisors which use the standard franchise agreements, such as awarding higher scores in evaluations of their fair trade and mutual growth agreements with franchisees. Franchisors with high evaluation scores may be exempt from ex officio investigations by the KFTC for certain period (one to two years).

The key amendments made by the KFTC are summarized below:

I. Provisions on the Designation of Mandatory Purchase Items

The recently amended the Franchise Act, effective July 2024, requires franchise agreements to include the types of products that franchisees must purchase from franchisors or parties designated by the franchisor (i.e., mandatory purchase items) and the criteria for calculating their supply prices. The KFTC has revised its standard franchise agreements to reflect this new obligation.

Below is an example clause from the standard franchise agreement for the general services sector:[2]

> **Article 29 (Designation of Mandatory Purchase Items)**
> (1) The franchisor may designate certain items that are essential for operating the franchise business and must be purchased from the franchisor or a designated supplier (hereinafter referred to as "mandatory purchase items") if purchasing such items from other suppliers would

1 Four from restaurant business sector (chicken, pizza, coffee, and general dining); five from service sector (education, beauty and haircare, auto repair, laundry, and general services); four from retail sector (convenience stores, cosmetics, health supplements, and general retail).

2 We have underlined the key parts.

make it difficult to protect the franchisor's trademark rights or maintain the uniformity of goods or services. If the franchisor designates mandatory purchase items, it must notify franchisees of the designated items (including their types, specifications, units, transaction parties, and applicable timelines) through [specify means, such as POS systems or internet websites]. The notified details become part of this franchise agreement.

(2) Franchisees must procure the mandatory purchase items designated under Paragraph 1 from the franchisor or designated suppliers. However, if the franchisor or designated suppliers fail to provide the items, or delay their supply for a reason other than natural or social disasters or other valid reasons, franchisees may procure the items for themselves with prior approval from the franchisor. In situations such as, or similar to, those where operational difficulties arise due to supply disruptions, franchisees may procure the items first and obtain approval afterward, provided the uniformity of the brand is not compromised.

(3) The franchisor may present quality control standards for mandatory purchase items that franchisees procure for themselves under Paragraph 2 and may audit compliance with these standards. In such cases, franchisees must cooperate with the franchisor's quality inspections.

(4) The franchisor must notify franchisees of the supply prices and the criteria for determining these prices (including applicable timelines) for mandatory purchase items through [specify means, such as POS systems or internet websites]. The notified details become part of this franchise agreement. However, in cases of significant price fluctuations caused by global supply instability due to reasons beyond the franchisor's control, such as natural disasters, wars, or pandemics, the notified pricing criteria may not apply.

(5) The franchisor must store and manage records of notifications made under Paragraphs 1 and 4 in written or electronic form for five years, allowing franchisees access at any time.

(6) The types of mandatory purchase items may change for reasons such as new product launches or product discontinuations. The supply prices and the criteria for determining these prices may also change due to changes in cost ratios or increases in raw material prices. However, unless otherwise agreed upon or under other special circumstances, such changes are limited to [specify number] times per quarter.

(7) The franchisor must promptly notify franchisees of any changes to the types, prices, or pricing criteria for mandatory purchase items through [specify means, such as POS systems or internet websites]. The notified details become part of this franchise agreement.

II. Provisions on Negotiating Changes to Transaction Terms

The recently-amended Enforcement Decree of the Franchise Act, effective December 2024, requires franchisors to (i) engage in negotiations with franchisees when changing transaction terms for mandatory purchase items to the disadvantage of franchisees, and (ii) include negotiation procedures for changing transaction terms, including those for mandatory purchase items. The KFTC has updated its standard franchise agreements accordingly. Additionally, the KFTC has ensured that the negotiation process for changing general transaction terms (other than those for mandatory purchase items) similarly incorporates some aspects of the procedures used for negotiating changes to the transaction terms for mandatory purchase items.

Below is an example clause from the standard franchise agreement for the general services sector:

Article 48 (Negotiations on Changes to Transaction Terms)

(1) The franchisor must negotiate with franchisees in cases where the transaction terms for mandatory purchase items are to be changed to the disadvantage of the franchisees, including the following scenarios:
   1. Forcing franchisees to engage in transactions with a specific supplier for items that were not previously required to be obtained from that supplier.
   2. Increasing the supply price per unit (e.g., quantity, volume, specifications, weight) of mandatory purchase items. However, this excludes cases where prices automatically increase based on the supply price calculation method stipulated in Article 29(4),[3] independent of the franchisor's intention.
   3. Changing the supply price calculation method for mandatory purchase items to the disadvantage of franchisees.
   4. Lowering the quality of mandatory purchase items.
   5. Reducing the range of suppliers for mandatory purchase items.
   6. Imposing additional incidental costs, such as transportation or inspection fees, on franchisees, or changing return policies, payment methods, or other transaction terms unfavorably to franchisees.

(2) Both the franchisor and franchisees must act in good faith throughout all negotiation procedures.

(3) Negotiation is also required when changes involve both unfavorable and favorable adjustments to transaction terms or when transaction terms for mandatory purchase items supplied by a designated supplier are changed to the disadvantage of franchisees.

(4) Negotiations must be conducted in person or remotely (e.g., through POS systems, email, online bulletin boards), depending on the scale and significance of the changes to the transaction terms.

(5) The franchisor must notify franchisees of specific details of the proposed changes, including the reasons and basis for changes, as well as negotiation methods and location, at least 10 days before the negotiation date. This notification must be delivered via written document, certified mail, email, internet website, mobile application, POS system, or similar methods. For remote negotiations, the franchisor must provide a negotiation period of at least 10 days from the date of notification, during which franchisees can freely submit their opinions.

(6) During the negotiation process, the franchisor must respond in good faith to franchisees' requests for relevant data or factual confirmations and provide explanations for its stance on the opinions submitted by franchisees.

(7) Once negotiations are concluded, the franchisor must notify franchisees of the results, including:
   1. The date, location, method, and participants of the negotiations.
   2. Opinions submitted by franchisees and the franchisor's position and reasoning.
   3. The finalized transaction terms or decisions reached through the negotiations.

(8) Negotiations must be completed before implementing changes to the transaction terms for mandatory purchase items. However, if there are valid reasons, such as significant concerns over the disclosure of trade secrets, negotiations may be conducted after the changes are implemented. In such cases, negotiations must begin immediately after the reason preventing prior negotiations is resolved, and the notification required under Paragraph 5 must include the reasons why prior negotiations could not be conducted.

(9) Negotiations under Paragraph 1 may be replaced by negotiations with a franchisee association if at least 70% of all franchisees agree.

3 Article 30 appears to be a typo, so it has been corrected to Article 29.

(10) When negotiating changes to transaction terms for mandatory purchase items supplied by a third-party supplier designated by the franchisor under Paragraph 3, the negotiations may address various topics, including changing suppliers or converting the items into recommended purchase items.
(11) The procedures outlined in Paragraphs 4 through 7 shall also apply similarly to negotiations on matters other than changes to the transaction terms for mandatory purchase items, such as negotiations on changes in transaction terms based on contract or necessity.

III. Provisions on Credit Card Payment Restrictions

The KFTC clarified in its standard franchise agreements for 11 business sectors that franchisors must not force or encourage cash payments by restricting credit card payments to specific locations. However, the standard franchise agreements for two sectors—laundry and convenience stores—do not include these provisions, as credit card payments are considered unnecessary due to the nature of their businesses.

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