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Newsletter of the INTERNATIONAL COMMERCIAL TRANSACTIONS, FRANCHISING AND DISTRIBUTION COMMITTEE

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Editor's Note

Happy New Year and welcome to the first Committee Newsletter of 2014. The focus of this edition is on the United Nations Convention on Contracts for the International Sale of Goods (CISG). The idea of a CISG-focused edition of the newsletter sprang from a spirited ListServe discussion on the topic about a year ago. That discussion was probably the most extensive (if not the only) substantive discussion on a particular legal topic conducted on the Committee's ListServe, and a large number of people contributed to the discussion. There was clearly a lot of interest in the topic, a significant number of viewpoints on a variety of issues surrounding the CISG, and a fair amount of misunderstanding. As of September 2013, 80 countries have adopted the CISG, making it a significant issue for those of us who represent clients in signatory countries in connection with the cross-border purchase and sale of goods. We hope the articles that follow will help educate and further the discussion about this important topic.

In addition, following up on the franchise-focused edition in the Fall of 2013, we have an update on the recent amendments to South Korea's Fair Transactions in Franchise Business Act. This update is timely since the amendments become effective on February 14, 2014, only a couple of days after the release of this Newsletter.

As always, many thanks to everyone who contributed to this issue. This newsletter would not be possible without your involvement and the gracious contribution of your time, knowledge and expertise.

We continue to welcome your suggestions, your ideas and, above all, your participation so that, together, we can make these newsletters a vibrant forum for addressing important topics and showcasing the expertise of our members.

Michael Daigle, Editor
February 12, 2014

Committee Leadership

(2013-2014)

Co-Chairs:	Michael Daigle (michael.daigle@chengcohen.com) Arnold Rosenberg (arosenberg@cwsl.edu)
Immediate Past Chairs:	Caryl Ben Basat and William Johnson
Senior Advisor:	Alan Gutterman
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COMMITTEE NEWS

Greetings:

We've reached roughly the half-way point in the current bar term. Much has been accomplished, much more is to come, and preparations are already being made for the 2014-2015 bar term. As a Committee, we are continuing to have a great year with many opportunities for members to actively engage. We continue to have our regular monthly Committee conference calls on the 3rd Wednesday of each month (noon eastern). The February call is scheduled for Wednesday, February 19. Everyone is welcome to dial in and either actively participate or just listen in. Watch the ListServe a day or so before the scheduled call for the agenda and dial-in information.

Following is a recap of some of the Committee's upcoming activities, many of which will be covered in more detail during the regular monthly call:

Upcoming Activities:

- **2014 Spring Meeting** – The SIL's Spring Meeting will take place at the Waldorf Astoria in New York City from April 1-5, 2014. Our Committee is the primary sponsor of two programs that will be presented during the Spring Meeting. Jack Graves will be presenting a 1-hour breakfast program on "*5 Essential Things Every Business Lawyer Ought to Know About the CISG*" (Thursday, April 3, 2014, 8:00am). Our co-chair, Arnold Rosenberg, will lead a panel discussion on "*Secured Transactions At Home and Abroad: New Developments*" (Friday, April 4, 2014, 10:45am). We encourage everyone attending the Spring Meeting to attend and support these two valuable programs and to acknowledge Jack's and Arnie's hard work in putting their programs together. We will discuss in this month's call the possibility of scheduling a Committee gathering for those attending the meeting.
- **2014 Fall Meeting** – The SIL's Fall Meeting will take place at the Hilton Buenos Aires in beautiful Buenos Aires, Argentina, from October 21-25, 2014. We are happy to report that two of the three programs we put forward have been accepted for presentation at the meeting. Tom Collin's program "*Navigating Antitrust Laws in Product Distribution in Latin America*" and Bill Johnson's and Michael Daigle's program "*The Hidden Traps of Foreign Sales Intermediaries*" made the cut. More details to follow as the programs are finalized and time slots are assigned.
- **Committee Leadership Roles** – The deadline to self-nominate for leadership roles during the 2014-2015 bar term expired February 7, 2014. However, we continue to look for volunteers to serve in Committee leadership roles. Openings are available for Programs, Projects, Membership and Communications & Website. If interested in assisting in these or any other areas, please contact one of the Committee Co-Chairs.
- **Spring Newsletter** – The Spring 2014 edition of the Committee's quarterly Newsletter will be published in mid-May 2014. That edition will focus on recapping developments during 2013 on issues of interest to the Committee. The deadline for submission of articles will be beginning of May. More information to follow.
- **Committee Webpage** – The link to our Committee's webpage on the ABA's website is: http://apps.americanbar.org/dch/committee.cfm?com=IC732000. The webpage holds a description of the Committee and its mission, a copy of the Committee's business plan, Committee roster, copies of prior newsletters, and minutes of our monthly conference calls. Please check in on the webpage as we continue to improve and update the content.
- **Committee Business Plan** – We must update the Committee's business plan by February 24. The business plan was attached to the minutes of the last monthly Committee conference call which can be found on the Committee's webpage (see link above). We'll be discussing those updates during the February 19 call.

Our combined mission is to make this Committee one of the SIL's most active, providing the highest quality materials, and delivering the most value to its members. We hope you'll help us get there and that you'll join us in these and other activities that will be made available through the Section and this Committee. Enjoy the articles that follow!

Michael Daigle, Co-Chair
Arnold Rosenberg, Co-Chair

BRIEF CONSIDERATIONS ON THE RATIFICATION OF THE CISG BY BRAZIL

By Nelson Felipe Kheirallah Filho

On March 3, 2013, Brazilian President Dilma Russef sanctioned the legislative decree which approved the text of the UN Convention on Contracts for the International Sale of Goods of 1980, and Brazil became the 79th country to ratify the Convention since 1980, the year of its creation.

Under the terms of the Convention -- that determines its entry into force in the signatory State on the first day of the month following the expiration of twelve months after the date of the deposit of its instrument of ratification (Article 99(2)) -- it will enter into effect in Brazil on April 1st, 2014.

The Convention -- which is known worldwide as CISG -- regulates the international sale of goods and is adopted by the major players in international trade. An estimated 80% of international transactions of goods involve signatory States of the Convention.

Currently being the 7th largest economy in the world, the largest in Latin America, Brazil will most likely benefit from the Convention, which decisively contributes to establish a safer legal environment between Brazilian-located companies and those located elsewhere, as it standardizes the legal rules applicable to contracts for the international purchase and sale of goods. To note, Brazil's five major trading partners - China, the United States, Argentina, Germany and Japan - are all signatory States.

The advantage of the Convention rests in bringing neutral rules, widely known and accepted, specifically designed for the international sales of goods and written in an accessible-to-all fashion. Throughout its articles, the Convention seeks to balance the interests of buyer and seller, without discriminating. Add to it the existence of abundant scholarly writing and a plethora of international case law (estimated about 2,500 sentences), available to be used as reference.

These features of the Convention confer predictability to the parties and, consequently, generate cost savings by simplifying the rules of the game, especially to small and medium-sized enterprises dealing in international trade that sometimes cannot afford legal counsel.

The Convention deals with the formation of international sales, the obligations of the buyer, the obligations of the seller, the transfer of risk, the breach of the contract, the rights available to each party and other contract issues. These are all rules of substantive law, describing the rights and obligations of each party to the international transaction, and which are already applicable to Brazilian-based companies in a few cases.

Given the material nature of the Convention rules, the issue that may arise is whether its dispositions are consistent with the Brazilian 2002 Civil Code, which regulates commercial transactions in general. Generally, yes, but there are points that may be conflicting.

As an example we may cite the Convention requirement that the buyer informs the seller in case of lack of conformity of the goods received "*within a reasonable time after he* [buyer] *has discovered it or ought to have discovered it*" (Article 39). When (purposely) not defining what "*reasonable time*" is, the Convention left upon the discretion of the courts to define it. There are varying understandings ranging from thirty (30) days to 24 (twenty four) hours, depending on the nature of the goods. Under the Brazilian 2002 Civil Code, however, the buyer has a thirty (30) day period from the effective delivery of the goods or knowledge of the irregularity to inform the seller. One may anticipate that this issue will be decided differently from the provisions of the Brazilian 2002 Civil Code when faced by local courts.

Another example is the Convention requirement that a breach be fundamental to motivate avoiding the contract. Under the Convention, the breach is fundamental "*if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract*" (Article 25). The Brazilian 2002 Civil Code does not require a *fundamental* feature. The right to termination due to violation by the other party is guaranteed by the Brazilian 2002 Civil Code for any and all contractual violation.

Also, the Convention stipulates that "*damages for breach of contract consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach*" and may not exceed "*the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known possible consequence of the breach of contract*"

(Article 74), while the Brazilian 2002 Civil Code imposes no restrictions to require payment of damages.

These differences -- as well as others not herein mentioned -- should not be viewed by Brazilian courts as irreconcilable. If, however, this is not the case, they should decide in favor of the Convention.

Besides being committed to observe and respect international instruments to which it accedes, there are at least 03 principles deeply embedded into the Brazilian legal framework that would justify this approach. First, newer legislation overrides older legislation when both govern the same factual situation (*lex posteriori derrogat legi priori*), and the Convention was ratified in 2013, after the promulgation of the Brazilian 2002 Civil Code; second, specific law overrides general law (*lex specialis derrogat legi generali*), and the Convention specifically addresses international sale of goods, while the Civil Code provides for the purchase and sale of goods in a general, broad fashion; and, finally, any and all agreements should be respected (*pacta sunt servanda*), and the Convention is deemed as an agreement between Brazil and the international community.

In any event, although Brazil is formally bound by the Convention only from April 1st, 2014, it already applies to commercial transactions where the rules of international law lead to its application.

For instance, the Convention would apply to a company headquartered in Brazil making business with a company domiciled in China, which has incorporated the Convention in its legal system, if both elect Chinese law to resolve disputes arising out of the transaction. Having both agreed to submit their contract to Chinese laws, or to the laws of any other country that has also incorporated the Convention, the Convention will govern the contract of sale, even though the Brazilian company may ignore the fact that the Convention applies.

The Convention may be applicable even when neither party is domiciled in a signatory State. This would be the case, for example, of a Brazilian-based company contracting with an English-based company (which has not ratified the Convention) the purchase and sale of specific goods covered by the Convention and both elect neutral law for resolution of controversies, a common scenario in international trade. If both parties were to elect French law, the Convention would apply to this commercial relationship. Although neither Brazil (prior to April 1, 2014) nor the UK are signatories to the Convention, France is, and the reference to French law subject both parties to the CISG and therefore to its provisions.

Principles and application notwithstanding, the ratification of the Convention by Brazil will impact international business transactions carried out by Brazilian-located companies. Learning to correctly navigate the Convention, understanding its intricacies and its application, is paramount for Brazilian international players.

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RECENT CHANGES TO KOREAN FRANCHISE LAW

By Philippe Shin, Byung-Tae Kim and Hyunju Lee

I. Introduction

The franchising industry in Korea has rapidly grown in recent years, both quantitatively and qualitatively, and has experienced significant development and stability over the years as a number of overseas franchises (e.g., brand name food products, coffee shops and restaurants), have entered the Korean franchise market, in addition to the massive entries of large Korean conglomerates into the market. The rapid development of the Korean franchising industry is also partly due to the 1997 Asian financial crisis, an unintended consequence of which was that it provided people who suddenly became unemployed an opportunity to rebound by getting into franchise business since franchise businesses require considerably few specialized skills or startup capital.

Although the history of Korean legislation regulating franchise businesses is comparatively short, based on the development of the Korean franchising industry and the tendency for franchisees (in most cases individuals or small merchants) to be in an inferior bargaining position to franchisors, the Korean government strives to better protect the rights of franchisees against considerably stronger conglomerates, and has thus moved in the direction of amending the relevant laws and regulations.

The Fair Transactions in Franchise Business Act (the "**Franchise Act**"), which was enacted on May 13, 2002, became effective on November 1, 2002. Prior to the enactment of the Franchise Act, franchisor-franchisee relationships, in particular with regard to unfair trade practices of franchisors abusing their dominant positions, were regulated by the Monopoly Regulation and Fair Trade Act (the "**MRFTA**") as well as by the guidelines on standards of unfair trade practices of franchise businesses enacted in April 1997 (the "**Franchise Guidelines**").

The main difference between the Franchise Act and the Franchise Guidelines was the fact that the Franchise Act offered a wide range of protection to the different stages leading to the signing of a franchise agreement and the various stages following the consummation of a franchise transaction, including the recruitment of franchisees. On the contrary, the Franchise Guidelines only regulated franchisors' unfair trade practices. Other differences introduced by the Franchise Act include specific protection devices for the protection of franchisees which require franchisors to comply with certain obligations such as the requirement to file an information disclosure statement (the "**IDS**") and to provide in advance terms and conditions of the franchise agreement to the franchisee.

Given such policy considerations, the Franchise Act allows substantial protection for the benefit of franchisees, and foreign companies which intend to engage in a franchise business in Korea should pay particular attention to the degree of protection provided to franchisees. In this article, we will introduce the key provisions of the current Franchise Act as well as the main aspects of the recent amendments to the Franchise Act.

II. Applicability of the Franchise Act

Any person subject to the Franchise Act will face considerable statutory restrictions before signing as well as during the implementation of the franchise agreement. In addition, the person will also be subject to review by the Korea Fair Trade Mediation Committee ("**KOFAIR**") following the execution of the franchise agreement. As such, prior to entering into a franchise agreement, it is important to first determine whether or not the intended business constitutes a "franchise" pursuant to the Franchise Act. The Franchise Act defines the term "franchise business" as a continuous business relationship in which a franchisor allows its franchisees to use its own trademarks, service marks, trade names, signs, or any other business marks (collectively referred to as "**Business Marks**") in selling commodities (including raw materials and auxiliary materials) or services in conformity with certain quality standards or business methods, and supports, trains, and exerts some degree of control over its franchisees' management, operation of its business. In return, franchisees pay franchise fees to their franchisor for the use of the Business Marks, the support and training provided for the management and operation of its business. If a business meets the criteria of a franchise business set forth above, such business shall be subject to the Franchise Act regardless of the size of the franchisee, unless the relevant franchise business is extremely small[1]. Moreover, the title of the contract that the parties will sign will not matter: if the characteristics of the relationship in substance meet the above criteria, then the Franchise Act will apply. For example, a trademark license could be deemed as a franchise if the above conditions are met.

The Korean Fair Trade Commission (the "**KFTC**") determines whether a business constitutes a franchise business based on the following four requirements pursuant to the definition of the franchise business provided in the Franchise Act:

(i) *Granting permission to use the Business Marks*. The KFTC's position is that the Business Marks, the use of which is being permitted, do not require registration if a third party may independently recognize trademarks.

(ii) *Support, training and control – Sales based on franchisor's standards*. If the failure to follow a business policy proposed by a franchisor has no detrimental effect on a franchisee, the KFTC's view is that the relevant business shall not be deemed a franchise business. In addition, if a franchisee sells only products and services which are not related to the main business of the franchisor, the business conducted by the franchisee does not constitute a franchise business in the eyes of the KFTC.[2]

(iii) *Franchise fees paid in consideration for the use of the Business Marks and provision of support, training and control*. In this connection, it should be noted that, in the KFTC's view, the supply of commodities at prices higher than wholesale prices is deemed as payment of a franchise fee.

(iv) *Continuous business relationship*. If the support provided by a franchisor is only temporary, the relevant business does not constitute a franchise business.

III. Main Characteristics of the Franchise Business

The establishment of specific procedures which are to be complied with prior to the signing of a franchise agreement, including the filing of an IDS and the return of franchise fees[3], for purposes of protecting franchisees is of great significance. Such procedures should be taken into consideration by foreign franchisors which intend to engage in a franchise business in Korea. We set forth below a brief explanation of the main characteristics of the franchise business pursuant to the Franchise Act[4].

A. Obligation to register and provide in advance an IDS.

The Franchise Act provides that a franchisor shall, prior to the execution of a franchise agreement, register with the KFTC[5] an IDS, and that such registered IDS shall be provided to the franchisee at least 14 days (or 7 days if a prospective franchisee has consulted an attorney or a franchise consultant with respect to the IDS) prior to the execution of the franchise agreement or receipt of a franchise fee (Articles 6-2 and 7 of the Franchise Act).[6] Such system, which requires potential franchisors to file an IDS, has been designed to enable a prospective

[1] The Franchise Act shall not apply if (i) the total franchise fee that a franchisee pays to a franchisor for six (6) months from the date of the initial payment of the franchise fee does not exceed KRW 1 million and (ii) the annual sales of a franchisor are less than KRW 50 million (provided, however, that, the threshold shall be KRW 200 million if the franchisor had established and operated a direct retail store for more than a year to sell commodities or provide services in accordance with the quality standards and business methods of the relevant franchise business prior to the commencement of the relevant franchise business).

[2] In this regard, according to a court's decision, "support, training and control provided by a franchisor" should be interpreted as restrictions imposed on the business hours, location and business area of a franchise store, as well as restrictions on the interior and exterior design of the franchise store which are necessary to maintain standardization and conformity among franchise stores. However, the court further ruled that requiring the franchisee to actively participate in marketing and promotion, restricting a franchisee from expanding its online services beyond the authorized territory, or prohibiting the franchisee from unreasonable use of the online services shall not be deemed a significant degree of control exercised by the franchisor (Seoul High Court decision, 2010*Na*62798, rendered on December 21, 2010).

[3] Franchisee can demand the return of the franchise fee in certain cases such as the violation of the Franchise Act by the franchisor, including not providing an IDS or receiving franchise fee before the end of the 14-day period from delivering the IDS. Please refer to Section III.C below.

[4] Provisions prohibiting unfair trade practices, including provision of unfair terms in a franchise agreement or franchise transactions, are included in the Franchise Act. However, as such provisions do not substantially differ from those contained in the MRFTA and the Regulation of Standardized Contracts Act, except for certain exceptions which are allowed due to the nature of the relevant franchise business, we will not elaborate in detail on unfair trade practices performed by franchisors.

[5] The KFTC was originally in charge of handling the registration and review of IDSs. However, as discussed later in the article, such duties of the KFTC have been delegated to the Korea Fair Trade Mediation Agency since January 1, 2013.

[6] An IDS is registered, in principle, within 30 days from the date of filing for registration; provided, however, that the review process may be extended in case additional materials are requested by the KOFAIR during its review of the IDS.

franchisee to thoroughly review before signing the key elements of the franchise business, including, but not limited to, the franchisor's business performance, the terms and conditions of the franchise agreement and various costs and expenses to be borne by the prospective franchisee. The underlying assumption of this prerequisite to the start of the franchise business is that a prospective franchisee is generally an individual or a small merchant who may not have the resources to gather information about the franchisor. Any person who fails to comply with the aforesaid obligations may be subject to imprisonment for a term of not more than two years or a criminal fine not exceeding KRW 50 million, or simply be subject to corrective measures or other administrative fines.

B. Prohibition of false or exaggerated information.

The Franchise Act prohibits a franchisor from providing false or exaggerated information or omitting material information upon execution of a franchise agreement, and should certain information, including information on sales and profits, be disclosed to a prospective franchisee, the Franchise Act requires the franchisor to disclose such information in writing (as well as keep evidence to support such information.)

In addition, if a franchisee or prospective franchisee requests information relating to the existing franchise store's sales and profits and the prospective franchisee's expected future profits, the franchisor shall allow such prospective franchisee or franchisee to inspect the relevant information upon request (as well as keep evidence to support such information) (Article 9 of the Franchise Act). Any person who provides false or exaggerated information or omits material information may be subject to imprisonment for a term of not more than five years or a fine not exceeding KRW 150 million[7]. Further, any person who fails to provide the aforementioned information in writing, keep evidence to support such information, or provide the requested information may be subject to a fine not exceeding KRW 10 million.

C. Return of Franchise Fees – Deposit of Franchise Fees.

The Franchise Act provides that a franchisee or prospective franchisee may recover from the franchisor the applicable franchise fee in the event the franchisor engages in certain illegal acts such as failing to provide an IDS, providing false or exaggerated information, or unilaterally suspending the franchise business (Article 10 of the Franchise Act).

A franchisor is required to have the franchisee deposit the franchise fee[8] with a financial institution (not with the franchisor), and such deposit will be paid to the franchisor only upon the commencement of the franchise business by the franchisee or two months after the signing of the franchise agreement, whichever is the earlier (Article 6-5 of the Franchise Act); provided, however, that a franchise fee is not required to be deposited with a financial institution in case a damage compensation insurance for franchisees or a debt guarantee agreement is entered into by the franchisor to compensate for damage that the franchisee may potentially suffer (Article 15-2 of the Franchise Act). In this regard, it is important for foreign franchisors to note that domestic commercial banks which provide franchise fee deposit services do not, in practice, provide such services to foreign franchisors that do not have a liaison office or branch office in Korea. Thus, it is common for foreign franchisors to enter into a damage compensation insurance for franchisees which is generally offered by guarantee insurance companies. Any franchisor who fails to comply with the aforesaid obligations may be subject to imprisonment for a term of not more than two years or a fine not exceeding KRW 50 million, or may also be subject to corrective measures or other fines.

D. Prohibition against denying renewal of franchise agreement and restrictions on termination of franchise agreement.

The Franchise Act requires that the term of a franchise agreement be long enough to protect franchisees and contain provisions preventing unfair early termination of

[7] The Amendment to the Franchise Act discussed below also prohibits the provision of false or exaggerated information to franchisees, in addition to prospective franchisees, and has enhanced punishment by increasing the fine to KRW 300 million in case of violation of the above requirement.

[8] Franchise fee that must be deposited with a third party consists of (i) consideration (e.g., membership fees) that a franchisee pays to a franchisor to obtain a franchise license, including a license for the use of the Business Marks, or to receive support for a training on his business activities, such as membership fees, admission fees, franchise fees, training fees, or down payments; and (ii) consideration (e.g., deposit) that a franchisee pays to a franchisor as a security for the payment of obligations or damages incurred in connection with the purchase price for commodities supplied by the franchisor.

franchise agreements. In case of the breach of such obligations, corrective measures or fines may be imposed. If a franchisee requests the franchisor to renew a franchise agreement during the period between 180 and 90 days prior to the expiry of the franchise agreement, such request shall not be rejected by the franchisor without justifiable reasons. If the franchisor does not notify the franchisee of its intent to decline the request to renew the franchise agreement, the franchise agreement shall be deemed to have been renewed under the same terms and conditions as the original franchise agreement (Article 13 of the Franchise Act); provided, however, that a franchisee's right to request the renewal of a franchise agreement may be exercised only if the total term of the franchise agreement, including its initial term and successive renewals, does not exceed ten years. If the initial term of a franchise agreement is more than ten years, there should not be any particular issues with the right to exercise the renewal of such franchise agreement.

In addition, any franchisor that intends to terminate a franchise agreement shall clearly state in its notice of termination to the franchisee what clause of the franchise agreement the latter breached, and grant a grace period of not less than two months. The franchisor must give at least twice the written notice that it will terminate the agreement unless such breach is rectified during the given period. The termination of a franchise agreement in breach of the above requirement shall not be effective (Article 14 of the Franchise Act); provided, however, that a franchise agreement may be terminated with immediate effect if it is difficult to continue franchise business transactions due to exceptional circumstances such as the bankruptcy of the franchisee, suspension of the franchise business, or illegal acts by the franchisee.

IV. Institution in Charge of Franchise Transactions

The KOFAIR is currently responsible for reviewing registration of IDSs as well as mediating disputes involving franchise transactions. The KOFAIR, an institution affiliated with the KFTC, which was established for the purposes of resolving, in a timely manner, disputes involving damage suffered by small and medium-sized companies as a result of unfair trade practices (relating to fair trade, franchise business transactions, subcontracting transactions, etc.) through autonomous mediation between the parties, was, until January 1, 2013, only in charge of mediating disputes pertaining to franchise business transactions.

In relation to disputes or damage involving a franchise business, any party seeking relief may apply for mediation to the KOFAIR. In such cases, the KOFAIR recommends the parties to the dispute to reach an agreement or proposes a settlement. Unless special circumstances exist, sanctions such as corrective orders issued by the KFTC are generally lifted.

Due to the nature of franchise businesses, as most of the franchisees tend to be individuals or small merchants, franchisees prefer in most cases to resolve disputes by mutual consultation between the parties rather than by relying on court procedures which are often costly.[9] Disputes on franchise businesses accounted for the largest portion of the cases handled by the KOFAIR, and the settlement rate reaches 80%.

IDSs were initially reviewed by the KFTC; however, the KOFAIR, due to its expertise in franchise matters, has also been assigned the responsibility of reviewing IDSs since January 1, 2013 to manage the overall tasks of franchise businesses, so as to ensure a rapid and efficient review of IDSs.

Thus, as the KOFAIR is now simultaneously dedicated to tasks relating to the review of IDSs and mediation of disputes on franchise businesses, the KOFAIR has now taken center stage with respect to franchise business transactions.

V. Recent Trends – Amendments to the Franchise Act and its Enforcement Decree

The fundamental objectives of the Franchise Act are to protect franchisees and to prevent franchisors from engaging in unfair trade practices based on the understanding that franchisors generally enjoy an economically superior position, bargaining power and easier access to information and resources than franchisees. A number of franchisor-franchisee relationships indeed correspond to this description. In particular, due to the recent increase in disputes between franchisors and franchisees resulting from the rapid growth of franchises in the businesses of bakery and confectionery, fast food, coffee shops, and convenience stores, the KFTC has established model standards for franchise transactions which include restrictions on the distance from the newly launched stores, a period during which a franchise store's interior must be renovated and the party who must bear the expenses relating to such renovation, to protect franchisees. Although such model

[9] The number of Korean court precedents on franchise businesses is small due to the high costs associated with court procedures.

standards are not binding regulations, the KFTC has continuously worked to protect franchisees that may become more vulnerable by encouraging regulations set forth in the model standards to be reflected in the IDSs and franchise agreements.

In July 2013, as part of the government's policy promoting "economic democracy", the National Assembly passed an amendment to the Franchise Act (the "**Amendment to the Franchise Act**"), which has become effective on February 14, 2014, adding supplemental protection for franchisees. The KFTC has introduced an amendment to the Enforcement Decree of the Franchise Act which includes details of the Amendment to the Franchise Act. The key aspects of the Amendment to the Franchise Act are detailed below.

A. Registration of IDS and prohibition of false or exaggerated information

The Amendment to the Franchise Act requires franchisors to provide an IDS by content-certified mail or other means[10] such as electronic mail with automatic receipt notification from which the date of provision of information can be objectively identified. The Amendment to the Franchise Act strengthens the overall disclosure obligations by (i) requiring franchisors to specify whether they have violated the Korean Act on the Regulation of Standardized Contracts and information on franchisor's assistance for the management and sale activities of franchisees in disclosure documents, and (ii) increasing the amount of the fine in case of provision of false or exaggerated information.

The most noteworthy amendment relating to a franchisor's obligation to provide information is the obligation to provide information on expected future sales in writing. Under the Franchise Act, a franchisor must allow a prospective franchisee to inspect information on expected future sales upon request. However, the Amendment to the Franchise Act and the draft of the Enforcement Decree of the Franchise Act now require all franchisors over a certain size (i.e., the franchisor is not a small and medium-sized company or there are more than 100 franchise stores) to provide prospective franchisees with the scope of estimated sales[11] and the relevant calculation grounds in writing at the time of execution of a franchise agreement, and such franchisors shall maintain such information for five years from the date of execution of the franchise agreement.

B. Business area protection system

Before the Amendment to the Franchise Act, there was no provision requiring the franchisor to define a business area. The Amendment to the Franchise Act now provides that, when executing an agreement, the franchisor is obligated to define and stipulate the business area for a franchisee in the agreement. Further, the franchisor is not permitted to set up another franchisee or any shop of the same trade or otherwise directly operated by the franchisor in the same business area without justifiable reasons; provided, however, that in the event of any cause stipulated by the Presidential Decree (including but not limited to changes in commercial districts, changes in floating population and purchasing power and changes in product demand), the business area may be reasonably adjusted through consultation between the franchisor and the franchisee at the time the relevant franchise agreement is renewed. This new provision is scheduled to become effective on August 14, 2014, which is one year after the enactment of the Amendment to the Franchise Act, as its implementation must in practice be preceded by a grace period to adapt to the new requirements.

C. Cost sharing for store renovation

The Amendment to the Franchise Act prohibits a franchisor from imposing store environment improvement on its franchisees without justifiable reasons (objective deterioration of the store, poor safety and sanitation). Under the Amendment to the Franchise Act, a franchisee will bear the cost of store environment improvement at a rate determined by the Presidential Decree[12], to the extent that such rate is less than 40% (Article 12-2).

D. Measures to strengthen Franchisee's negotiation leverage

Moreover, the Amendment to the Franchise Act permits franchisees to form an organization to protect their rights and advance their economic status. The Amendment to

[10] Disclosure documents may be delivered personally only if a confirmation note written in the prospective franchisee's own handwriting is provided.

[11] In relation to the scope of expected future sales of the prospective franchisee's store for one year from the commencement of the business by the prospective franchisee, the maximum amount of the expected future sales must not exceed 1.3 times the minimum amount of the expected future sales.

[12] The amendment to the Enforcement Decree of the Franchise Act (draft) provides that (i) in case of store environment improvement which requires moving and expansion, the rate will be 40% and (ii) in case of store environment improvement which does not require moving and expansion, the rate will be 20%.

the Franchise Act grants a franchisee organization, composed of franchisees using the same Business Marks, the right to request consultation on transaction terms, including modification of a franchise agreement, with the franchisor, while obligating the franchisor to sincerely respond to such request. Meanwhile, under the Amendment to the Franchise Act, the franchisor shall not penalize franchisees on the grounds that they have formed, have been admitted to, or have been involved in a franchisee organization. In the event of violation of the foregoing, the franchisor may be subject to corrective measures or a fine (Articles 14-2, 33 and 35).

VI. Conclusion

As franchisees are, in principle, significantly smaller in size and less accessible to information than franchisors, there exists a need to protect franchisees. Recently, the presence of foreign franchisors in the Korean market has grown tremendously; in such cross-border franchise transactions, since domestic conglomerates are often the franchisees (or master franchisees), the franchisors and franchisees may be deemed to have comparable bargaining power (and, not infrequently, the Korean franchisee's size may be considerably larger than that of the foreign franchisor). In such case, the applicability of the Franchise Act, a law which is inclined to protect franchisees, in its present state, may not conform to the legislative intent and is likely to lead to unreasonable results. Moreover, in certain cases, franchisors and franchisees are required to incur unnecessary costs and exert considerable efforts to comply with certain clerical requirements of the Franchise Act. Further, the exceptions to the Franchise Act are allowed based only on the relevant franchisor's annual sales and the initial franchise fee, and as such standards tend to be interpreted stringently, there are in fact very few cases where the Franchise Act will not apply. Based on the foregoing, we believe that all the provisions of the Franchise Act do not necessarily need to apply to all franchise business transactions. We would like to see exemptions from the Franchise Act extended based on the actual transaction by taking into account the size of the relevant franchisee and number of franchisees, each party's negotiation leverage, and specific relationship between the parties. When the Franchise Act is not applicable, unfair trade practices may be regulated by general laws and regulations, including but not limited to, the MRFTA and Act on the Regulation of Standardized Contracts.

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WAIVER OF LATE NOTICE OF NON-CONFORMITY UNDER ART 39(1) CISG

By Dr. Christopher King

On March 26, 2013, the *Bundesgericht* (highest court of Switzerland) decided a case of significant practical importance relating to belated notice of non-conformity under Art. 39 CISG. As most readers of this Newsletter know, in light of the provision for uniform international interpretation rule of Art. 7(1) CISG, the decision can be relied on outside of Switzerland as well.

In the case (No. 4A_617/2012, which can be viewed on the website of the *Bundesgericht*: www.bger.ch), a Swiss importer purchased three types of citrus fruit juice from a German supplier that were to supposed to have "Bio Suisse" certificates. Both Germany and Switzerland are signatories to the CISG, which accordingly applied to this sales contract pursuant to Art. 1 CISG. The seller delivered the juice but not the certificates. Six months later, the buyer noticed that the certificates were missing and requested the certificates. The seller provided the certificates two months later. The purchaser claimed damages for the late delivery of the certificates. The seller claimed that the purchaser lost its claim of non-conformity of the goods, which includes certificates related to the goods, under Art. 39 CISG by waiting more than "a reasonable time", since the six months delay was unquestionably longer than a "reasonable time" within the meaning of Art. 39(1) CISG.

The buyer claimed that the seller waived its defense under Art. 39(1) CISG by agreeing to furnish the certificates after the time for a reasonable notice had expired. Art. 39(1) CISG is not a mandatory provision of law and can be (and often is) waived by sellers.

The *Bundesgericht* held that the mere agreement to furnish the certificate was *not* a waiver of seller's rights under Art. 39 CISG. Such a waiver would have to show an express intention to accept the legal consequences, i.e. to be liable for the non-conformity despite the overdue notice. Mere actions to cure the non-conformity cannot be viewed as constituting such a waiver.

This was the case, even though the seller *in casu* only raised the issue of CISG 39(1) at a very late stage in the pleadings.

The reasoning of the *Bundesgericht* is not limited to non-conforming or missing documents, but also would apply to any other actions intended to cure the non-conformity of a delivery, e.g. sending a revised operating manual after the buyer could not get the product or a certain feature to work but had let the reasonable notice period (often held to be six weeks) expire. The case underlines the significant protection Art. 39 provides to sellers and the need for buyers to give prompt notice of non-conformity if they wish to preserve their rights.

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OPTING OUT OF CISG: ALWAYS THE BEST APPROACH?

By Sam Wieczorek

Failure to Meet Expectations

In the United States, use of the United Nations Convention on Contracts for the International Sale of Goods ("CISG") has not lived up to expectations. In fact, a 2008 survey of American attorneys likely to encounter CISG in their practices, found that the "overwhelming majority," when negotiating or drafting an international sales contract, elect to opt out of CISG. Often that decision is made reflexively, triggered by factors such as client and attorney unfamiliarity with CISG, the additional time and cost to analyze CISG in light of the transaction at issue, and a shortage of U.S. court decisions interpreting CISG.[1] But is reflexively opting out of CISG always the best solution? This article will explore some of the factors that might be considered in order to make an informed, rather than a reflexive, decision on whether to embrace some or all of the provisions of CISG.

Many American practitioners incorrectly believe that CISG is "foreign" law or that it derogates state law.[2] This is wrong. CISG is American law. It is a self-executing treaty, and accordingly, no subsequent congressional action is required to make it effective. CISG, therefore, is substantive sales law in all 50 states.[3] Unless a party expressly opts out of CISG in a sales contract between parties who are located in different "Contracting States," it will govern interpretation of the contract.[4] For this reason alone, it is important to have at least a basic knowledge of CISG. Indeed, at least one author has estimated that 70 to 80% of all international transactions are potentially covered by CISG, in many cases unbeknownst to the parties.[5]

Why American Lawyers Tend to Reject CISG

The following are some common reasons that American lawyers cite for their reluctance to use CISG. First, customary parol evidence rules don't apply when interpreting contracts governed by CISG.[6] Under the standard American parol evidence rule, in general, a writing intended by the parties to be the final embodiment of their agreement cannot be varied by evidence of earlier agreements or negotiations. This means that in most cases, a party cannot introduce evidence of negotiations that preceded the signing of the agreement.[7] By contrast, under CISG, when determining a party's intent, CISG instructs courts to consider all relevant circumstances including the parties' negotiations, established practices between the parties, and any subsequent conduct of the parties. This ability to go outside the four corners of a contract likely gives many American practitioners concern that the unambiguous words of the contract might be varied by the parties' pre- or post-signing conduct. However, such a rule could be helpful in cases where a client wishes to vary the terms of the agreement based on pre-signing negotiations.

Second, and closely aligned with the parol evidence rule, is that CISG requires courts to consider the parties' subjective intent when interpreting a contract. If the court cannot discern the parties' subjective intent, then it will look to what a reasonable person would believe.[8] As with the parol evidence rule, this ability to vary the terms of a contract, using the parties' subjective intent--or not even the parties' intent, but a *reasonable person's* belief of what the parties' intent would have been--causes hesitation for practitioners accustomed to relying on the four corners of a contract.

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[1] Philippopoulous, George V., *Awareness of the CISG Among American Attorneys*, 40 No. 3 Uniform Commercial Code L.J. ART 4 (Winter 2008).

[2] Fitzgerald, Peter L., *The International Contracting Practices Survey Project: An Empirical Study of the Value and Utility of the United Nations Convention on the International Sale of Goods (CISG) and the UNIDROIT Principles of International Commercial Contracts to Practitioners, Jurists, and Legal Academics in the United States*, 27 J.L. & Com. 1, 4 (Winter 2008). In response to his survey, one New York lawyer expressed concern with ceding "states' rights" to a foreign body of law. Another lawyer did not want to cede U.S. law to an "international body."

[3] Kokoruda, Christopher C., *The UN Convention on Contracts for the International Sale of Goods -- It's Not Your Father's Uniform Commercial Code*, 85-Jun Fla. B.J. 103 (June 2011).

[4] CISG art. 1 and art. 6.

[5] Kokoruda, *supra*, at n.11 *citing* Ingeborg Schwenzer & Pascal Heschem, *The CISG -- Successes and Pitfalls*, 57 Amer. J. of Comparative Law 457, 457 (2009).

[6] CISG art. 8(3).

[7] *Black's Law Dictionary* 1149 (8th ed. 2004)

[8] CISG art. 8(1), 8(2).

A third common objection to CISG is that it contains no statute of frauds. A contract need not be in writing to be completely enforceable under CISG.[9] However, analyzing this difference should lead one to ask, why this difference would matter. If a sales contract need not be in writing under CISG, and if CISG automatically applies in international sales contracts unless expressly opted out of, then any time there was an allegation of an oral contract, CISG would presumably govern. So, although this is a common objection to CISG among some lawyers, this difference probably shouldn't matter in most contexts.

A fourth common objection to CISG is that it does not contain a perfect tender rule. Under typical state UCC laws, if the goods purchased or their delivery fail to conform *exactly* to the contractual description, the buyer may reject the goods or accept only a portion of the goods and reject the rest.[10] By contrast, under CISG, the buyer may avoid the contract only in the case of "fundamental breach."[11] A breach is "fundamental" only if it substantially deprives the other party of what he or she expects under the contract.[12] Understandably, practitioners may prefer to avoid having to prove a "fundamental" breach in advising a client whether to void a contract.

When Using CISG May Make Sense

The foregoing list of differences with American law is certainly important to be aware of. However, rather than reflexively opting out of CISG in all cases, American lawyers may serve their clients better by making an informed decision, on a case-by-case basis, when deciding whether or not to opt out of CISG. The following section summarizes some reasons why a practitioner might select CISG to govern an international sales contract.

First, the inclusion of CISG may put a client in a stronger negotiating position if his lawyer is aware of the tenets of CISG but other counsel is not. Such a knowledgeable practitioner would be able to select certain provisions of CISG that apply or don't apply. At a minimum, it would give the lawyer another set of laws to compare for favorability for his or her client, rather than just mechanistically applying local sales law.

Another reason is that in the case of certain foreign laws, it may be preferable for the more uniform CISG to apply than another country's laws. For instance, some practitioners elect to have CISG govern in lieu of Chinese law because CISG is easier to understand, in their opinion, than Chinese law.[13]

Other practitioners elect to use CISG when a given contract contains mandatory arbitration. These practitioners feel that CISG is easier for international arbitrators to understand and apply.[14]

Another aspect to consider, if dealing with a corporate client who has a policy of opting out of CISG in all cases, is that it may be beneficial to reexamine this policy from time to time to make sure it still accomplishes the client's goals. This is particularly true as more and more case law is created interpreting CISG. Or if a client's form sales contracts contain a mandatory arbitration provision, it may make sense to use CISG instead of local law.

Consider also that opting out of CISG isn't an all-or-nothing proposition. CISG allows parties to opt out of certain provisions of CISG.[15] For instance, if you're not comfortable with waiving the statute of frauds, then you could opt out of Article 11. If you don't want to contend with evidence of course of dealing, then you could opt out of Article 9.

What if, after performing this analysis, you decide that you'd still like to opt out of CISG applicability for a transaction? It is not enough merely to rely on a choice-of-law provision that applies a particular state law. You must affirmatively opt out of CISG applicability.[16] However, opting out of CISG would not end the analysis. At this point, you must determine which jurisdiction's laws would apply. This may require you to become familiarized with another country's laws if the other party is in a stronger negotiating position.

Conclusion

Although opting out of CISG may still be a lawyer's preferred practice, an understanding of its differences will, at least, give the lawyer another tool when negotiating an international contract. For this reason

[9] CISG art. 11 ("A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses.")
[10] UCC § 2-601.
[11] CISG art. 49.
[12] CISG art. 25.

[13] Philippopoulous, *supra*.
[14] *Id*.
[15] CISG art. 6.
[16] CISG art. 6; *BP Oil Intern., Ltd. v. Empresa Estatal Petroleos*, 332 F.3d 333, 337 (5th Cir. 2003) ("Where parties seek to apply a signatory's domestic law in lieu of the CISG, they must affirmatively opt-out of the CISG.").

alone, it is worth reviewing CISG and understanding its main differences from the UCC. At a minimum, counsel needs to be aware that simply staying silent on CISG in the context of an international sales contract does not equate to opting out of CISG. There must be a provision specifically opting out of all or some of CISG.

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