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Are You Thinking About China?

By Paul Jones

Retail sales in China were up 15% in August. This year, more cars have been sold in China than in the United States. China is already clearly headed out of the recession.

If you have been thinking about entering the China market to diversify your revenue stream, here are some legal issues to consider.

Will Your System Be a Franchise Under Chinese Law?

Over that last year, a number of cases have become available to help answer this question. In China, much more emphasis is placed on the uniformity of the system rather than on the element of control, as in the United States.

In a decision in Beijing dated Oct. 10, 2008 (*Wang Jing v. Beijing Ruili Sunshine Beauty Co., Ltd.*), the court first looked at the definition of a "franchise" in the Franchise Regulation to determine whether a contract was a "franchise agreement." The translated definition is as follows:

> Article 3 — In this Regulation a commercial franchise (hereafter referred to as a "franchise"), refers to an arrangement whereby an enterprise (hereafter referred to as a "franchisor") through an agreement grants other operators (hereafter referred to as the "franchisees") the

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New 'Dualing' Amendments to Dealer-Protection Laws Pass Legislatures

States Deal Automakers Another Blow

By Rick J. Gibson, Jeffrey J. Jones, J. Todd Kennard and Douglas M. Mansfield

Historically, some automobile manufacturers have sought to focus their own dealers on that manufacturer's brands to the exclusion of competitive brands. Many auto dealer contracts prohibit "dualing," that is, operating competing linemakes out of the same facility. Under new legislation passed in some states, automobile manufacturers could be forced to allow dualing, notwithstanding any terms to the contrary in written agreements and trademark laws.

The South Carolina legislature added new provisions that make it unlawful for a manufacturer to prohibit a dealer from being involved in managing, investing in, or acquiring any other make or line of new motor vehicles if: 1) "the requirements are unreasonable considering current economic conditions and are not otherwise justified by reasonable business considerations"; 2) the dealer has maintained a reasonable line of credit for each line; and 3) the dealer remains in compliance with reasonable capital standards and reasonable facilities requirements specified by the manufacturer. *See* S.C. Code Ann. § 56-15-75. Under the new provision, "[r]easonable facilities requirements shall not include any requirement that a motor vehicle dealer establish or maintain exclusive facilities, personnel, or display space, unless the manufacturer or distributor establishes by a preponderance of the evidence that such requirements are justified by current economic conditions or reasonable business considerations." *Id.*

The Illinois legislature passed a provision that makes it a violation for a manufacturer to require a dealer to exclude or remove competitive operations as long as the dealer maintains a reasonable line of credit for each line, the dealer remains in compliance "with any reasonable facilities requirements of the manufacturer," and the addition of the linemake "would be reasonable," among other things. *See* 815 Ill. Comp. Stat. 710/4(d)(8). The amendment expressly provides that "reasonable facilities requirement" "shall not include any requirement that a

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franchisee establish or maintain exclusive facilities, personnel, or display space," and places the burden on the manufacturer to overcome the presumption that the dealer's decision is reasonable. *Id.*

Impact on Automakers and Possible Legal Issues

A manufacturer makes very significant investments in its branding strategy and its unique image that it tries to convey to customers. The recent amendments could eviscerate those efforts by severely curtailing, if not effectively eliminating, a manufacturer's ability to prohibit a dealer from conducting competitive operations out of the same store. Marketing expenditures to promote a brand over the years may be compromised if the manufacturer is forced to allow a competitor's products to be sold out of the same facility. Manufacturers could also expect to lose confidential competitive information, which manufacturers routinely provide to dealers.

There are several potential legal arguments to challenge the legislation. There is "legitimate reason for a manufacturer's desire to exert control over the manner in which [its] products are sold and serviced." *Cont'l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 55 n.23 (1977). Exclusivity provisions can be based on a desire to focus a dealer's efforts on the manufacturer's product line(s) and, in turn, on limiting the chances that the manufacturer's marketing and investment efforts in attracting customers will be lost to competitors. *See Brattleboro Auto Sales, Inc. v. Subaru of New England, Inc.*, 633 F.2d 649, 652 (2d Cir. 1980) (party could reasonably have concluded that sales and service of Subaru cars would suffer as a result of simultaneous promotion of several lines of directly competing cars); *Hendricks Music Co. v. Steinway, Inc.*, 689 F. Supp. 1501, 1513 (N.D. Ill. 1988) ("Steinway is wholly dependent on the efforts of its network of exclusive and independent dealers to promote its name and its product line," and "allowing the existence in one dealership of two competing [concert and artist] programs could create conflicts of interest within the dealership in attempting to represent the two different programs."). Pro-dualing legislation contradicts those policies and the manufacturer's business judgment concerning the sales and service of its own products.

Trademark law also might provide a basis for objection. "The right to use a trademark is recognized as a kind of property, of which the owner is entitled to the exclusive enjoyment to the extent that it has been actually used." J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 214 (4th ed. 2008) (internal quotation omitted). As one federal appellate decision noted, "'the cornerstone of a franchise system must be the trademark or trade name of a product.'" *Susser v. Carvel Corp.*, 332 F.2d 505, 516-17 (2d Cir. 1964) (Lumbard, C.J., writing for the majority in part and dissenting in part) (quoting district court). As the same court explained, "[t]he requirement that only Carvel products be sold at Carvel outlets derives from the desirability that the public identify each Carvel outlet as one of a chain which offers identical products at a uniform standard of quality. … It is in the public interest that products sold under one particular trademark should be subject to the control of the trademark owner." *Id.* at 517.

Section 15 U.S.C. § 1125(a)(1)(A) provides that a civil action may be filed in connection with any goods or services that use a symbol or device that "is likely to cause confusion, or to cause mistake, or to

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Employee Free Choice Act Slowed, But Not Dead

By Kevin Adler

Although passage of the federal Employee Free Choice Act ("EFCA") has taken a distant back seat to health care reform, the proposed changes to workplace unionization and collective bargaining rules have significant potential impacts for business owners. Employer representatives have denounced EFCA, while union backers are pushing hard for passage of the law.

On Sept. 1, the ABA Center for Continuing Legal Education produced a webinar that looked at the key provisions of EFCA and the prospects for its passage — with a specific focus on the possible impact on franchisors and franchisees. The four presenters, split evenly into pro-labor and pro-employer camps, gave starkly contrasting perspectives on the current state of labor union law and the changes that EFCA might produce.

EFCA is designed to "level the playing field" in worker-management relations, said Dr. John Logan, director of research, Labor Center, Institute for Research of Labor and Employment, University of California-Berkeley. He described the current system as bedeviled by "coercive" employers that "deny employees free choice" to unionize. He cited surveys that indicate a majority of workers would like union representation.

However, from management's perspective, almost every claim that Logan made is suspect. In the webinar, David French, vice president of government relations for the International Franchise Association, referenced one prominent study that found that only 9% of nonunion workers say they want to join a union. French argued that EFCA is solving a problem that does not exist. "This bill is based on one premise … that unionization should be inevitable in the workplace," he said, and he added that provisions in EFCA would undermine workplace democracy, rather than expand it.

Kevin Adler is associate editor of *FBLA*.

Key Provisions of EFCA

EFCA's three key provisions are:

- Majority Support Recognition ("Card Check"). For a union to be certified today, a majority of workers in a potential bargaining unit must sign a card requesting a union election. Then, the employer can recognize the union, or it can require an election. If the union wins a majority of votes in the election (and the bargaining unit is valid), the union is formed. With EFCA, if the union presents a sufficient number of legitimately signed cards, the National Labor Relations Board ("NLRB") could certify the union without an election.
- Prompt First Contract. Today, there is no timetable for conclusion of good-faith negotiations on a first contract between a new union and an employer. Sometimes, the negotiations go on for years without a contract. EFCA would require that bargaining begin within 10 days of a union being certified (or later, if both parties agree), and it would allow either party to demand mediation after 90 days. If mediation fails, either party can demand binding arbitration for a first contract that will be valid for two years.
- Remedies for Unlawful Acts. EFCA would increase the monetary penalties for employers who are found to be intimidating or firing workers because of union activities.

Card Check is the most contentious aspect of the proposed legislation, and it's the part that is least likely to survive the legislative process, said William Sokol, senior partner with Weinberg, Roger & Rosenfeld (Alameda, CA), the largest union-side law firm in the country. "[Sen.] Arlen Specter [D-PA] has told us … that we should not expect to see Card Check as part of the final law," said Sokol.

Yet, Sokol argued that even if it is passed, Card Check is a "tweaking" of the system, not a wholesale change in the law. The NLRB recognized signed union cards as the basis for union certification in the 1930s, he said.

However, Richard J. Curiale, managing partner, Curiale Hirschfeld Kraemer LLP, (San Francisco), who represents employers in labor disputes, pointed out that unions can bend the rules in order to get cards signed — and that's why secret-ballot elections are so important. "The union can say anything to get the card signed; this is not a regulated part of the law," he said. "The only thing the union can't do is to threaten a worker with violence … but it can misrepresent what's on the card in order to get it signed."

Employees sign union cards for many reasons, Curiale continued, referencing his experience in more than 200 organizing campaigns on the union side. "Maybe the employee just wants more information about the union," he said. The secret ballot is the true test of whether the worker wants union representation, he said.

But given employers' other powers related to workplace union activity, Sokol challenged the idea that secret ballots are fair. "Imagine if you had an election in America for political leaders where one candidate could force you to attend his rallies or could prevent the other candidate from doing any daytime campaigning. Or one candidate, even if the other one wins the election, he can delay the winner taking office for years," said Sokol.

One alternative to Card Check that's been floated by union proponents is a requirement that elections be held quickly after cards requesting a union are validated, perhaps in as little as five days. But French noted flaws with that plan from an

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employer's perspective. "The union may have had maybe six months to build a case with employees" to get cards signed, said French. "[In a quick election], the employer will be carved-out completely and will not be able to exercise free speech."

"That's propaganda," responded Logan. "Employers have unlimited access to employees all of the time at the workplace."

Franchises As Targets

The panelists also discussed which types of franchises would be affected if EFCA is passed. Unions focus on large employers, so hotel chains might be targeted with more union organizing, said Sokol. But he predicted that franchises that have few employees, such as most retail operations, will be untouched.

"Historically, unions have been good for small businesses that compete in local labor markets," Logan added. "Unions reduce turnover, which reduces training — and that's important to a small business. Unions also can pool together workers to reduce health care costs."

However, French and Curiale said that the complexity of union law would be a nightmare for any franchisor or franchisee, especially smaller ones. "For the average franchise, a single-unit operator with eight employees, this is a very challenging law," said French. "That franchise does not have a labor lawyer on retainer. So the rule about having a quick election presents a challenge in knowing what the employer and the front-line supervisor can and cannot do. It's easy to commit an unfair labor practice."

Franchises also should be wary about binding arbitration for the first contract, said Curiale. "I have no problem with a neutral hearing an arbitration, but I do have a problem with someone hearing the facts and writing a contract that an employer has to live with for two years," he said. "It takes away any leverage the employer has in bargaining."

IFA's French added, "Franchising is a relationship between a franchisor and franchisee, and now [EFCA would impose] a third party in the room, an arbitrator. There's the potential for some very capricious contracts."

Summary

The panelists did agree on several points. First, none of them predicted that EFCA with Card Check will pass Congress. "It's likely that the final version of EFCA may not include Card Check. It may include a system of quick elections with harsher employer penalties and some form of first-contract arbitration," said Logan.

Second, none of the panelists foresee EFCA passing soon. "Sen. Harry Reid [D-NV] says it's off the agenda for now; health care is the priority. My expectation is that we will not see it [reach a vote] until 2012," said Sokol.

"I wouldn't rule it out before then," said French, "But it is off the table as long as Sen. Reid is unsure he has 60 votes of support for what he is bringing up."

Finally, even a tough EFCA would not necessarily open the door for rapid or large-scale unionization. "Is this bill all bad? The answer is no," said Curiale. "But it is killing a fly with a sledgehammer."

"Frankly, there's plenty of room for franchisors and franchisees to slow down the union process," Sokol said. "The truth of the matter is that competent employer lawyers are going to immediately raise all kinds of issues: Are the signatures genuine? Are the cards real? What is the appropriate bargaining unit? … There can still be all kinds of litigation hearings that still make the process somewhat of a farce or the cumbersome, bureaucratic mess that it is today."

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> right to use its business operating resources, including registered trademarks, logos, patents, and proprietary technologies; whereby the franchisee conducts business under a uniform mode of operation; and whereby the franchisee pays franchise fees according to the agreement. No entity or individual other than an enterprise may conduct business as a franchisor.

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The court said that in the agreement in question, the defendant (and alleged franchisor) was required to provide a complete management experience, including the defendant's technology, management support and methods of identification. It said that because the two sides signed a contract that had the characteristics of a "franchise agreement," then it was a "franchise agreement."

However, plaintiffs in other cases have not been successful in claiming that a particular contract is a franchise agreement. The Suzhou Intermediate People's Court in Jiangsu Province ruled in *Zhao Bin v. Jiangsu Longli Qisheng Biotechnology Co., Ltd.*, (dated Aug. 6, 2008) that the contract under consideration did not involve the licensed use of intellectual property rights or a unified business model, and therefore it was not a franchise agreement. Similarly, in a case in Beijing (*Tianjin Jinsui Tax Technology Co., Ltd. v. Taiji Computer Co., Ltd.*, dated Nov. 17, 2008), in an unfortunately brief analysis, the court agreed with the defendant that the agreement in question was in the nature of a "sales agency contract," not a franchise agreement. There was no evidence that the defendant provided for a license to use intellectual property, according to the court.

It should be noted that the Chinese term for franchising, "texujingying," which first appeared in 1997, has been used in broader contexts than the relationships covered by the Franchise Regulations. The word has also been used to refer to authorized dealerships (*See Hu Aihe*

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COURT WATCH

By Darryl A. Hart
and Charles G. Miller

Franchisor's Decision Not To Renew Franchisee's Lease

A U.S. District Court in New Jersey has held that if a franchisor, as sublessor of the lease of the franchised location, elects not to renew its master lease, it may terminate a Franchise Agreement denominated as a Commission Marketer Agreement ("CMA") that was coterminous with the lease. In *Luso Fuel Inc. v. BP Products North America, Inc.* CCH Bus. Franchise Guide ¶14,166 (D. N.J., June 29, 2009), the plaintiff became a gasoline station franchise in July 2007 as the transferee of a prior owner. Since 1970, the defendant franchisor and its predecessor had a ground lease on the station premises that it subleased to its franchisee. The ground lease was to expire in December 2008, unless the defendant renewed it, which it had the right to do "at its election." The CMA stated that the term of the franchise was subject to the term of the ground lease. In June 2008, the plaintiff was notified by the defendant that the defendant had lost its right to continue its tenancy, and, therefore, the CMA would terminate at the end of 2008. The plaintiff spent a considerable sum of money on the location based, it claimed, on the defendant's assurance that the lease would be renewed.

The plaintiff sued the defendant on a variety of theories, including violation of the New Jersey Franchise Practices Act ("NJFPA"), misrepresentation, and breach of the implied covenant of good faith and fair dealing. In a not-for-publication opinion, the court granted the defendant's motion to dismiss, heard as a motion for summary judgment.

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The court held that even though the franchisee was in good standing under the CMA and the NJFPA prohibits the termination of a franchise except for good cause, defined as "failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise," the termination was for good cause. This was because the termination, while not strictly in keeping with the language of the NJFPA, was not arbitrary or capricious since the CMA provided for the termination of the franchise upon the expiration of the ground lease, and that was a clear and nondiscriminatory standard. The defendant merely executed a negotiated contract right not to renew the ground lease, a right of which the plaintiff was aware.

The plaintiff disputed the defendant's claim that the defendant did not have the right to renew the ground lease, and it claimed that the defendant verbally represented that it would renew the lease. The court found that these claims were immaterial since the CMA and the ground lease specifically gave the defendant the right to renew the lease "at its election," and the merger clause of the CMA precluded reliance on terms not in that agreement, such as the alleged promise to renew.

The claim that the defendant's refusal to renew the lease violated the implied covenant of good faith and fair dealing (which, if found to apply, would prevent the defendant from doing anything to prevent the plaintiff from receiving the benefits of the CMA) was not applicable, according to the court, since the covenant could not be used to alter the express terms of the agreement giving the defendant the right not to renew the lease. Similarly, the plaintiff's misrepresentation claim was found to be without merit since the defendant merely did what it had the right to do under the contract, and reliance on the alleged representation that defendant would renew the lease was, as a result, unwarranted and was prevented from consideration by the parol evidence rule. The fraudulent inducement exception to the parol evidence rule did not apply, according to the court, since the plain terms of the contract contradicted the alleged representation on which the plaintiff claimed to rely.

The lesson: "Get it in writing," and do not rely on promises not in a contract, particularly if the contract contains terms contrary to the promises on which one's client may seek to rely.

Enforcing Equitable Arbitration Awards

There are very few decisions that guide practitioners about the proper procedures to enforce either interim or final arbitration awards granting equitable relief. While arbitrators have the power under various rules to issue final or interim awards granting equitable or nonmonetary relief (*see, e.g.,* Rule 34, "Interim Measures," of the Commercial Rules of American Arbitration Association), practitioners have sometimes grappled with the issue of how to put teeth into those awards, especially where those awards may deal with discovery questions. A recent unpublished California appellate case is an excellent example of the advantages that can be obtained by enforcing a nonmonetary award that granted the franchisor immediate possession of the franchised premises on termination of the franchise. (Under Rule 8.1115(a), California Rules of Court, an opinion that is not certified for publication cannot be cited or relied on by a court or party.)

In *Mustard Franchise Corporation v. Yek, Incorporated,* Bus. Franchise Guide (CCH) ¶14,175 (Ca. Ct. App., June 24, 2009), the franchisor brought an arbitration proceeding seeking to terminate a franchise. After the arbitrator ruled in favor of the franchisor, the franchisor asked the arbitrator to enforce its repurchase rights and give it immediate possession of the franchised premises. When the franchisee failed to give the franchisor immediate possession, the franchisor filed an action in

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court for injunctive relief to obtain possession and sought to confirm the arbitration award.

The trial court treated the application for injunctive relief as a petition to confirm the award. By doing so, the franchisor was allowed to sidestep the usual showing to obtain a preliminary injunction or temporary restraining order ("TRO"), such as the posting of a bond, proving likelihood of success on the merits, balancing the hardships and showing irreparable harm. The appellate court affirmed this procedure, finding that, while seeking a preliminary injunction and TRO, the suit was in essence a petition to confirm the award. While the petition was a few days premature under California law (which requires that a petition can only be filed after 10 days have elapsed from the granting of the award, to allow a petition to correct the award), the court gave no weight to the argument because no prejudice was shown.

While the case cannot be cited or relied on (presumably because the court did not believe it paved any new ground), it can be beneficial to show how trial and appellate courts are likely to rule and the advantages with regard to confirmation of nonmonetary arbitration final or interim awards.

Domino's Not Vicariously Liable for Injuries Caused By Delivery Driver

In *Viado v. Domino's Pizza,* LLC 2009 WL 2766996 (Or. App. Sept. 2, 2009), an intermediate Oregon appellate court has adopted the rule that franchisors are not liable for the tortious acts of their franchisee's employees unless the franchisor controlled the manner of performance of the conduct causing the injury. The result will make it very difficult for an injured plaintiff to prove vicarious liability in Oregon on the part of franchisors and could signal a nationwide trend away from the traditional analysis of determining if the franchisee was simply an "agent" of the franchisor in determining vicarious liability. Some states have adopted the rule that in order to be liable, the franchisor must control the instrumentality that caused the injury. (*See Kerl v. Rasmussen, Inc.* (Wis. 2004) 682 N.W.2d 328, 342; *Exxon Corp. v. Tidwell* (Tex. 1993) 867 S.W.2d 19, 23.)

In *Viado*, the franchisee's employee's automobile collided with a motorcycle driven by the plaintiff. Negligence on the part of the employee was presumed for purposes of Domino's motion for summary judgment. The trial court granted the motion, and this was affirmed on appeal.

The court first determined whether the franchisee was an "employee-agent" or "non-employee agent" of the franchisor, an important distinction because if the franchisee is a "non-employee agent," the plaintiff would need to show that the franchisor had the right to control the specific conduct giving rise to the tort claim. The Domino's guides given to Domino's franchisees contained a number of "standards" pertaining to driver safety, such as requiring no cell-phone use, no looking for addresses, proof of insurance, good driving record, participation in safe-driving training, etc. The court also examined the franchise agreement and operating manual and pointed to a number of provisions (including dress codes, hours, order preparation and delivery, and advertising) that it found went beyond the stage of setting standards into controlling certain day-to-day operations, and it concluded that a reasonable juror could conclude that Domino's retained sufficient control over certain day-to-day operations of the franchisee to establish an agency relationship. While that determination might establish vicarious liability in other jurisdictions (like California), the court held that it was still necessary to determine whether the relationship created an "employee agency," in order to automatically foist vicarious liability on the franchisor.

The court determined that the franchisee was not an employee-agent because the franchisor did not retain the right to control the performance of services of the franchisee. Because of the complex nature of the franchise relationship, the franchisee was not deemed an "employee-agent," even though the franchisor had the right to control many facets of the franchisee's business. Of import to the court's decision were the absence of any compensation from Domino's and the franchisee's retention of rights to assign or transfer the business, the right to place advertisements, and the responsibility for site development.

Even though the franchisee was not an employee-agent, this still did not end the inquiry, since a franchisor could be liable for the acts of its non-employee agents if the franchisor retained the right to control the manner of performance of the conduct in question, meaning that the franchisor must be shown to control the physical details of the manner of performance of the subject conduct. The plaintiff argued that Domino's had this right of control by its creation of detailed standards over the franchisee's drivers. Issuing overall "standards" was not enough, said the court, since none of them related to the physical details of the manner of driving. The fact that Domino's required driver training or imposed driving safety standards was of no import because none of these led to the accident. The court hinted that if Domino's had established particularized driving standards regarding the physical details of driving, such as prescribing the route that drivers must take, liability might have been found.

The decision still leaves some uncertainty as to what it would take to impose liability on the franchisor. Even if Domino's controlled the route (which might be the case with many airport shuttle franchisors), for example, unless the accident resulted from something unsafe as to the route, there still might not be liability. It remains to be seen what will be necessary to impose liability on a non-employee agent.

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deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person. …" If the amendments are interpreted to have the effect of limiting or infringing upon the manufacturer's right to control its trademarks, the legislation could arguably be preempted in part by federal trademark law. Confusion as to the source of a product or service, even if eventually dispelled, does not necessarily eliminate any trademark issue. *See Promatek Indus., Ltd. v. Equitrac Corp.,* 300 F.3d 808, 812-13 (7th Cir. 2002) (Lanham Act claim involving use of trademark and discussing "initial interest confusion"; "[c]ustomers believing they are entering the first store rather than the second are still likely to mill around before they leave"; "using another's trademark in one's metatags is much like posting a sign with another's trademark in front of one's store") (internal quotation omitted)). If the added linemakes are perceived as having lower quality, the commingled operations could also dilute the original manufacturer's trademarks.

The legislation also might be vulnerable to constitutional arguments. In certain cases, intangible property rights protected by state law may deserve protection under the Takings Clause. *See, e.g., Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003-04 (1984) (recognizing intangible property rights can be protected by the Takings Clause); *Roth v. Pritikin,* 710 F.2d 934, 939 (2d Cir. 1983) (copyrights protected by the Takings Clause). A manufacturer could argue that an order allowing a dealer to market other manufacturers' products where the original manufacturer has contracted to operate an exclusive facility would be a misappropriation of the original manufacturer's trademarks, goodwill, or other rights created by state law. Such an order is arguably tantamount to a permanent physical invasion because it "eviscerates the owner's right to exclude others from entering and using [its] property — perhaps the most fundamental of all property interests." *Lingle v. Chevron U.S.A., Inc.,* 544 U.S. 528, 539 (2005). Thought could be given to other takings analyses under the balancing test articulated in *Penn Cent. Transp. Co. v. New York City,* which examines the character of the governmental action and the economic impact of the regulation on the claimant, particularly the extent to which the regulation has interfered with distinct investment-backed expectations. *See generally* 438 U.S. 104, 123 (1978).

The legislation also might be vulnerable to void-for-vagueness challenges. "It is established that a law fails to meet the requirements of the Due Process Clause if it is so vague and standardless that it leaves the public uncertain as to the conduct it prohibits or leaves judges and jurors free to decide, without any legally fixed standards, what is prohibited and what is not in each particular case." *Giacco v. State of Pennsylvania,* 382 U.S 399, 402-03 (1966). *See also Bass Plating Co. v. Town of Windsor,* 639 F. Supp. 873, 881 (D. Conn. 1986) ("[w]hen persons of common understanding and intelligence must guess at a rule's meaning and differ in its application then it is impermissibly vague."). Terms in the amendments such as "current economic circumstances" might be subject to challenge because they do not allow a manufacturer to know in advance whether its business judgment will be overturned by an agency on an arbitrary basis. That is particularly concerning, given that some statutes purport to allow or mandate an award of attorneys' fees if the manufacturer's business judgment is determined to be wrong.

Finally, the manufacturer can also challenge the amendments on the merits. If the dealer lacks the facilities, credit, or other criteria under the terms of the statute at issue, the court or agency may deny relief to the dealer seeking to add the competitive linemakes to the same facility under the statute's terms.

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v. Salt City Pavilion Lake Thrifty Window Blinds, Jiangsu Higher People's Court, June 2, 2006) and similar arrangements. Ministry of Commerce ("MOFCOM") representatives have verbally indicated that they intend to read the definition broadly.

In April 2009, judges from the Beijing courts, a MOFCOM representative, and others met in Beijing. Among their discussions was whether the uniform business model is the key element that defines a franchise. The MOFCOM representative said that paying royalties is not a prerequisite for being a franchise in China. In summary, a franchise agreement is created when there is a grant of rights, the payment of fees and a uniform mode of operation. This definition will tend to include more authorized dealers than the concept used in the United States.

Will Your System Be Operated in China?

Many franchisors have tried to avoid compliance with Chinese franchise requirements by having a Chinese master franchise set up an entity outside of China (which, for purposes of Chinese law, includes Hong Kong and Macau). The franchisor then grants the franchise for China to that entity. It is doubtful that this will work, although the arrangements have not yet been challenged in court. Article 2 of the Franchise Regulations is translated as "Commercial franchising activities conducted within the territory of the People's Republic of China shall comply with this Regulation." In other words, it is where the franchises operate that count.

Also, the outside-China arrangements have proven cumbersome for tax purposes, and some franchisors are trying to restructure them.

What About Compliance With the 2+1 Rule?

The increase in franchise litigation has created confusion over the status of the 2+1 Rule. The 2+1 Rule is in

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NEWS BRIEFS

H&R Block to Convert Up To 500 Company Units to Franchises

H&R Block has had "a strong initial response" to a refranchising program announced in September that could result in the sale of as many as 500 company-owned offices across the nation. H&R Block is offering offices across the nation, mostly in suburban or rural locations, as well as about 70 offices in the New York City, Los Angeles, and Houston metro areas.

"We've fielded a number of inquiries from people already inside the tax business and those interested in exploring taxes as a business opportunity," Ken Treat, senior vice president, franchise development, told *FBLA*, adding that entrepreneurs with tax experience are the company's targeted buyers. "Some of our existing franchisees are also very interested in expanding their operation."

Selection of offices to be sold is based on H&R Block's assessment of its potential as an office that is best served by having an entrepreneur who is "fully integrated into the community," said Treat, adding that "franchisees have long been an important part of our growth and our brand … We expect our operators to put in full-time best efforts to running the tax business."

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the second paragraph of Article 7 of the May 2007 Franchise Regulation, and it translates as, "For a franchisor to be engaged in franchising it must have at least 2 directly operated company-owned stores and have operated them for at least 1 year." It appears to be a primary requirement for franchising, but the courts have not been consistent in applying it.

For example, in *Wang Jin v. Beijing Sunlight Ruili Beauty Co. Ltd.*, the court specifically cited Article 7 of the Franchise Regulation and ruled that because it was not complied with, the franchise agreement was null and void.

However, in *Liu Yongxing v. Talent Cat (Beijing) International Brand Management Consultants Co., Ltd.,* decided by the Beijing No. 1 Intermediate Court on April 10, 2009, the appeal court upheld a decision of the Haidian District Court that said exactly the opposite:

> The provisions of Article 7 of the Franchise Regulations on eligibility requirements for franchisors are administrative provisions and not mandatory provisions, and thus a violation does not lead to the legal consequence that the contract is null and void.

There are several more cases on either side of this divide. Until recently, most of them were district court decisions, the lowest level for handling these matters.

The April 2009 meeting in Beijing of judges, MOFCOM, and others included extensive discussion of the 2+1 Rule. One side maintained that it is only an administrative provision, the breach of which may only impose administrative penalties (fines) on the franchisor, but will not invalidate the contract. The other side maintained that it was a substantive requirement, which, if not met, invalidated the franchise agreement.

What was most interesting is that the representative of MOFCOM and the most senior judge supported the "administrative" position. To Liu Jixiang of the Beijing Higher People's Court, the first part of Article 7, which requires a mature business model, is mandatory, but the second paragraph, the 2+1 Rule, is an administrative guide. If the 2+1 Rule is simply an administrative guide, this will be of major significance to foreign franchisors seeking to enter China. If they are comfortable that they have a mature business model, then they will not be liable for rescission. But how to handle the requirements of the filings with MOFCOM is another story. Fortunately, the representative of MOFCOM at the meeting stated that MOFCOM will consider locations held by indirectly owned corporations to be the same as locations directly held by the franchisor seeking registration.

Have You Registered Your Trademarks in English and Chinese?

Because of a backlog in the PRC Trademarks Office, the current estimate for a simple registration is three years. It is very difficult to translate most English brand names into Chinese. For a franchisor whose brand is only in English, the Chinese will create their own version of the brand; I have usually found inconsistent translations on official forms, such as the trademark registrations. For this reason, retailers often decide to create a new brand in Chinese.

There is still a problem in the PRC Trademarks Office with over-reliance on the Nice Classification system to determine when marks are confusing or not. Thus, it is prudent to register both Chinese and English marks in as many classes as the franchise budget will allow. Fortunately, registrations in China are not expensive.

Finally, when the franchise agreement is signed, a short-version trademark license agreement should also be signed and registered with the Trademarks Office.

There are other issues in China as well. Make sure that you have experienced counsel.

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