

Legal 500

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Japan

Franchise & Licensing

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This country-specific Q&A provides an overview of franchise & licensing laws and regulations applicable in Japan.

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Japan: Franchise & Licensing

1. Is there a legal definition of a franchise and, if so, what is it?

The term "Franchise" itself is not defined by law. However, pursuant to Article 4, Paragraph 5 of the Small and Medium-Sized Retail Business Promotion Act ("Retail Business Promotion Act"), a "Chain Business" is defined as "a business which, mainly for small and medium-sized retailers, continuously sells goods or arranges for the sale of goods, and provides guidance concerning business management, on the basis of a contract with standardized terms and conditions." In addition, pursuant to Article 11, Paragraph 1 of the Retail Business Promotion Act, a "Specified Chain Business" is defined as "a Chain Business in which the standardized terms and conditions of the relevant contract provide both that the member shall use a specified trademark, trade name or other indication, and that membership fee, deposit or other money shall be collected from the member at the time of joining." Franchise in the retail and restaurant industries fall within the scope of the Specified Chain Business, whereas franchise in the service industries not involving the sale of goods does not.

Furthermore, the Guidelines Concerning the Application of the Antimonopoly Act to Franchise Systems issued by the Japan Fair Trade Commission ("FTC") on April 24, 2002 (last amended April 28, 2021) ("FTC Guidelines") provide that, although the definition of a franchise system varies, in general, it is considered to be a business format whereby the franchisor grants the franchisee the right to use specified trademarks, trade names, or the like, and, with respect to the franchisee's sale of goods, provision of services, or other business and management, exercises control, provides guidance and renders assistance in a uniform manner, in consideration of which the franchisee makes monetary payments to the franchisor. Therefore, the Antimonopoly Act applies to franchise businesses regardless of the industry.

2. Are there any requirements that must be met prior to the offer and/or sale of a franchise? If so, please describe and include any potential consequences for failing to comply.

There are no special obligations other than the disclosure requirements set forth in answers to Question 4 below.

3. Are there any registration requirements for franchisors and/or franchisees? If so, please describe them and include any potential consequences for failing to comply. Is there an obligation to update existing registrations? If so, please describe.

There are no specific registration requirements for franchisors or franchisees.

4. Are there any disclosure requirements (franchise specific or in general)? If so, please describe them (i.e. when and how must disclosure be made, is there a prescribed format, must it be in the local language, do they apply to sales to sub-franchisees) and include any potential consequences for failing to comply. Is there an obligation to update and/or repeat disclosure (for example in the event that the parties enter into an amendment to the franchise agreement or on renewal)?

A person who conducts a Specified Chain Business (as described in answers to Question 1 above), when intending to enter into a contract with a person seeking to join such Specified Chain Business, shall, in advance, deliver to such person a written document stating the following matters and provide an explanation thereof (Article 11, Paragraph 1 of the Retail Business Promotion Act):

- i. Matters concerning membership fees, security deposits, and other money to be collected upon joining;
- ii. Matters concerning conditions of sale of goods to members;
- iii. Matters concerning guidance on business management;
- iv. Matters concerning the trademark, trade name, and other indications to be used;
- v. Matters concerning the term of the contract, renewal, and termination thereof;
- vi. In addition to the preceding items, matters specified by Ordinance of the Ministry of Economy, Trade and Industry (Article 10 of the Ordinance for Enforcement of the Small and Medium-Sized Retail Business Promotion Act).

In addition, the FTC Guidelines, Section 2(2)(a), also specifies matters which are desirable to be disclosed by the franchisor in soliciting franchisees. As stated in answers to Question 1 above, since franchises in the service industries fall outside the scope of Article 11, Paragraph 1 of the Retail Business Promotion Act, there is no statutory obligation for franchisors in the service industries to prepare a statutory disclosure document. However, the FTC Guidelines stipulate, from the perspective of preventing violations of the Antimonopoly Act in advance, that without limiting the type of business, it is desirable that even in the case of service industry franchises, the franchisor prepare, deliver and explain to prospective franchisees a document equivalent to the statutory disclosure document as stated above.

Delivery of the statutory disclosure document and explanation of its contents must take place prior to the execution of the franchise agreement; however, no specific deadline is prescribed. Nevertheless, the Voluntary Standards Concerning Disclosure of Information and Explanation to Prospective Franchisees ("JFA Voluntary Standards") issued by the Japan Franchise Association, a general incorporated association, serving as an industry organization for the domestic franchise sector ("JFA", see answers to Question 24 below), provide that, in entering into a franchise agreement, in order to ensure that the prospective franchisee has a sufficient period for consideration, there shall be a period of at least seven days between the completion of explanation with reference to the franchise agreement and the execution of such agreement. In light of this, it is considered desirable that delivery of the disclosure document and the explanation thereof be completed at least seven days prior to the execution of the franchise agreement.

Although no prescribed format is provided by law, the JFA has published the Guidelines for Preparation of Statutory Disclosure Documents titled "Summary and Overview of the Franchise Agreement", which provide reference examples.

While disclosure in the Japanese language is not explicitly mandated, from the perspective of ensuring adequate disclosure of information to franchisees, disclosure should be made in Japanese, unless there are special circumstances such as the franchisee's request for disclosure in a language other than Japanese.

Where a franchisee (sub-franchisor) conducts a business of selling membership rights to sub-franchisees, and such business falls within the Specified Chain Business (stated in answers to Question 1 above), the disclosure obligation shall likewise apply to the sale of membership

rights to sub-franchisees.

If the disclosure obligation is not observed, the competent minister may recommend to the relevant Specified Chain Business operator that the pre-contract disclosure be made in accordance with Article 11, Paragraph 1 of the Retail Business Promotion Act, and if such recommendation is not complied with, the minister may make a public announcement that such Specified Chain Business operator has failed to make the pre-contract disclosure (Article 12 of the Retail Business Promotion Act).

The Retail Business Promotion Act does not specifically provide for disclosure upon amendment or renewal of the franchise agreement. Where the franchise agreement is renewed with exactly the same terms and conditions as before, the necessity of disclosure of renewed agreement is virtually absent; however, where the franchise agreement is amended, disclosure in advance is considered desirable.

5. If the franchisee intends to use a special purpose vehicle (SPV) to operate each franchised outlet, is it sufficient to make disclosure to the SPVs' parent company or must disclosure be made to each individual SPV franchisee?

As a general rule, the pre-contract disclosure must be made individually to each franchisee. However, where respective franchisee SPVs designate their parent company's personnel as the contact person, it may be deemed sufficient, in practice, to deliver and explain, in aggregate, the statutory disclosure documents prepared for each franchisee SPV to such contact person.

6. What actions can a franchisee take in the event of mis-selling by the franchisor? Would these still be available if there was a disclaimer in the franchise agreement, disclosure document or sales material?

If a franchisor breaches its duty to provide information to the franchisee, and the franchisee suffers damage as a result, the franchisee may seek damages either for breach of the franchise agreement or under tort law. Furthermore, where the franchisor fails to make adequate disclosure or makes false or exaggerated disclosures, thereby inducing the franchisee to form an incorrect perception that the franchise system is significantly more advantageous or beneficial than it actually is, and thereby unfairly attracting prospective franchisees of

competitors, such conduct may constitute an unfair trade practice (fraudulent customer inducement) prohibited under the Antimonopoly Act. In such cases, where the franchise agreement in question violates the Antimonopoly Act to the extent that it can be regarded as contrary to public order and morals, it may also be possible to assert the invalidity of the franchise agreement. Even where the franchise agreement contains an exculpatory clause, such remedies may still be available if the clause is null and void on the grounds of public policy (Article 90 of the Civil Code) or the principle of good faith (Article 1, paragraph 2 of the Civil Code).

7. Would it be legal to issue a franchise agreement on a non-negotiable, "take it or leave it", basis?

Since there is no legal prohibition against offering a franchise agreement on a "take-it-or-leave-it" basis, provided that no other aspects of the offering violate the law, such a practice is permissible.

8. How are trademarks, know-how, trade secrets and copyright protected in your country?

Trademarks can be protected through registration under the Trademark Act, and in the event of infringement by a third party, such as unauthorized use, injunctions and claims for damages may be sought. While unregistered trademarks do not receive protection under the Trademark Act, where a third party makes unauthorized use of an unregistered trademark that is well-known or famous, it may be possible to seek claim damages or an injunction based on the Unfair Competition Prevention Act and other relevant laws.

Know-how and trade secrets are often protected by including confidentiality provisions in the franchise agreement. Furthermore, technical or business information that is useful for business operations, such as production methods or sales methods, which is kept confidential and not publicly known, may be protected as a "trade secret" under the Unfair Competition Prevention Act. If business interests are harmed by the unauthorized use of such trade secrets, injunctions and claims for damages may be pursued.

With respect to copyright, works that constitute "creations expressing thoughts or emotions in a literary, academic, artistic, or musical domain" are protected as "works" under the Copyright Act. In the event of copyright infringement, injunctions and claims for damages may be sought.

9. Are there any franchise specific laws governing the ongoing relationship between franchisor and franchisee? If so, please describe them, including any terms that are required to be included within the franchise agreement.

There are no franchise specific laws governing the ongoing relationship between franchisors and franchisees.

10. Are there any aspects of competition law that apply to the franchise transaction (i.e. is it permissible to prohibit online sales, insist on exclusive supply or fix retail prices)? If applicable, provide an overview of the relevant competition laws.

As stated in answers to Question 1 above, certain aspects of competition law are applicable to franchise transactions.

A prohibition on online sales may fall under "trading on restrictive terms", which is classified as an unfair trade practice prohibited under the Antimonopoly Act (Article 19, Item 12 of the General Designation (FTC public notice)). A restriction on online sales is considered justifiable only where there are reasonable grounds and the same standards are applied equally to other franchisees wishing to handle the relevant product.

Where the franchisor, holding a superior bargaining position in the transaction, compels franchisees, without legitimate reason, to deal exclusively with the franchisor or suppliers designated by the franchisor with respect to products, raw materials, or other procurement sources, beyond the extent necessary for the proper operation of the franchise system, thereby preventing franchisees from dealing with other suppliers capable of providing goods or services of good quality at lower prices, and thereby causing unjust disadvantage to franchisees in light of normal business practices, such conduct may constitute an abuse of a superior bargaining position under Article 2, Paragraph 9, Item 5 of the Antimonopoly Act.

Where the franchisor supplies products to the franchisees, any attempt to restrict the resale prices of the franchisees constitutes, in principle, "resale price maintenance" as prohibited under Article 2, Paragraph 9, Item 4 of the Antimonopoly Act. Even in cases where the franchisor does not directly supply products to the franchisees, if the franchisor unjustly restricts the prices of products or services supplied by the franchisees, such

conduct may fall under "trading on restrictive terms" which is classified as an unfair trade practice prohibited under the Antimonopoly Act (Article 19, Item 12 of the General Designation (FTC public notice)). The legality of such conduct is determined by comprehensively taking into account factors such as the conditions of the relevant regional market and the extent of the franchisor's involvement in the pricing of the franchisees.

In addition to prohibitions on online sales, requirements of exclusive supply, and the fixing of retail prices as stated above, "tie-in sales" which is likewise classified as an unfair trade practice prohibited under the Antimonopoly Act (Article 19, Item 10 of the General Designation (FTC public notice)) may also raise concerns.

Where any of the aforementioned violations occur, FTC may order the franchisor to take necessary measures to eliminate such conduct, including cessation of the conduct and deletion of contractual provisions (Article 20 of the Antimonopoly Act). In addition, abuse of a superior bargaining position and resale price maintenance are subject to administrative monetary penalty (Articles 20-5 and 20-6 of the Antimonopoly Act).

11. Are in-term and post-term non-compete and non-solicitation clauses enforceable and are there any limitations on the franchisor's ability to impose and enforce them?

Non-compete clauses are, in principle, enforceable; however, as they restrict the franchisee's freedom of business, particularly after the termination of the franchise agreement, they may be deemed void as contrary to public policy if the non-compete obligation imposes an excessive restriction. The validity of a non-compete clause is generally assessed by reference to the scope of prohibited business, the geographical area, and the duration of the restriction. The same considerations apply to non-solicitation clauses; however, as the restriction on the franchisee's freedom of business is less significant than in the case of non-compete clauses, the limitations on a franchisor imposing and enforcing a non-solicitation obligation are considered to be less stringent than those applicable to non-compete clauses.

12. Is there an obligation (express or implied) to deal in good faith in franchise relationships? If so, what practical effects does this have on the relationship between franchisor and franchisee?

The principle of good faith (Article 1, Paragraph 2 of the Civil Code) applies to franchise relationships, imposing an obligation on the parties to act in good faith. In franchise relationships, information asymmetries and economic disparities often exist between the franchisor and the franchisee, and in order to address these disparities fairly, certain duties under the principle of good faith may be imposed on the franchisor. At the time of entering into a franchise agreement, the franchisor typically possesses specialized knowledge regarding the franchise business, whereas prospective franchisees often lack such expertise. Accordingly, the franchisor bears a duty under the principle of good faith to provide the prospective franchisee with timely and accurate information necessary to make an informed decision as to whether or not to enter into the franchise agreement. Even after the franchise agreement has been concluded, the franchisor may, under the principle of good faith, be deemed to owe an obligation to provide appropriate managerial guidance and to maintain the brand value, even in the absence of explicit contractual provisions to that effect.

13. Are there any employment or labour law considerations that are relevant to the franchise relationship? Is there a risk that the staff of the franchisee could be deemed to be the employees of the franchisor? What steps can be taken to mitigate this risk?

Since a franchisee enters into a franchise agreement with the franchisor as an independent business operator, the staff of the franchisee are not formally considered employees of the franchisor. However, if a de facto employment relationship vis-à-vis the franchisor exists for the franchisee's employees (particularly, in relation to command-and-control authority or restrictions on working hours and location), they may fall within the scope of labor laws, such as the Labor Standards Act. To mitigate such risks, it is necessary not only for the franchisee to fulfill its obligations as the legal employer under labor-related laws (including payment of wages, management of working hours, and enrollment in social and labor insurance), but also to ensure that the franchisor does not issue direct instructions to the franchisee's employees, does not control their working hours or location, and that the franchisee clearly informs its employees that their employer is the franchisee, not the franchisor.

14. Is there a risk that a franchisee could be deemed to be the commercial agent of the

franchisor? What steps can be taken to mitigate this risk?

If it is not externally apparent that a franchisee operates as an independent business from the franchisor, there is a risk that the franchisee may be deemed a commercial agent of the franchisor. To mitigate this risk, the franchise agreement should explicitly state that the franchisor and the franchisee are independent business operators and that the agreement does not confer any agency status. In addition, measures should be taken to ensure that the franchisee clearly represents itself as an independent business operator from the franchisor on business cards and other communications and is prohibited from using the same or a confusingly similar name to that of the franchisor in the franchisee's corporate name or trade name.

15. Are there any laws and regulations that affect the nature and payment of royalties to a foreign franchisor and/or how much interest can be charged? Are there any requirements for payments in connection with the franchise agreement to be made in the local currency?

There are no specific laws or regulations governing the nature or payment of royalties to foreign franchisors, nor are there any statutory limits on interest rates applicable thereto. Furthermore, there is no legal obligation that payments under a franchise agreement be made in Japanese yen.

16. Is it possible to impose contractual penalties on franchisees for breaches of restrictive covenants etc.? If so, what requirements must be met in order for such penalties to be enforceable?

It is permissible to impose contractual penalties for breaches by the franchisee of restrictive covenants or similar obligations. For such liquidated damages provisions to be enforceable, (i) the imposition of the penalty must serve a legitimate purpose, (ii) the penalty must be necessary for the achievement of such purpose, and (iii) the penalty must be reasonable in light of a balance between the benefit accruing to the franchisor and the detriment imposed upon the franchisee.

17. What tax considerations are relevant to franchisors and franchisees? Are franchise

royalties subject to withholding tax?

As the franchisee is an independent business operator, it is required to file a tax return declaring income and expenses arising from store operations as business income and to pay income tax accordingly. In a domestic franchise arrangement in Japan, royalties paid by a corporate franchisee to a corporate franchisor are not subject to withholding tax. However, where a franchisee makes royalty payments to a foreign franchisor (i.e., a non-resident individual or a foreign corporation), such payments are, in principle, subject to withholding tax. That said, if the foreign franchisor maintains a permanent establishment in Japan, or where a tax treaty between Japan and the country of residence of the franchisor is applicable, withholding tax may be reduced or exempted. Franchise royalties are subject to consumption tax.

18. How is e-commerce regulated and does this have any specific implications on the relationship between franchisor and franchisee? For example, can franchisees be prohibited or restricted in any way from using e-commerce in their franchise businesses?

In addition to the Civil Code and the Commercial Code, which apply as general laws, e-commerce is subject to special legislation for consumer protection, including the Act on Special Provisions to the Civil Code Concerning Electronic Consumer Contracts and the Consumer Contract Act. It is also subject to disclosure regulations under the Act on Specified Commercial Transactions and advertising regulations under the Act against Unjustifiable Premiums and Misleading Representations. However, these regulations do not have any impact specific to the relationship between a franchisor and a franchisee. Restrictions imposed by the franchisor (for example, prohibiting or limiting the franchisee's use of e-commerce) may be permissible to the extent necessary to ensure the proper operation of the franchise system.

19. What are the applicable data protection laws and do they have any specific implications for the franchisor/franchisee relationship?

In the franchise business, when the franchisor or franchisee handles personal information, such as by receiving personal information from customers, the Act on the Protection of Personal Information ("APPI") applies. The regulations under the APPI do not have any particular impact specific to the franchisor–franchisee relationship.

20. Is the franchisor permitted to restrict the transfer of (a) the franchisee's rights and obligations under the franchise agreement or (b) the ownership interests in the franchisee?

The franchisor is permitted to restrict the transfer of the franchisee's rights and obligations under the franchise agreement and the ownership interests in the franchisee, to the extent necessary for the proper operation of the franchise system.

21. Does a franchisee have a right to request a renewal on expiration of the initial term? In what circumstances can a franchisor refuse to renew a franchise agreement? If the franchise agreement is not renewed or it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the compensation payment calculated?

Under Japanese law, there are no statutory restrictions regarding the maximum or minimum term of a franchise agreement, and whether a franchisee may request renewal upon expiration of the initial term depends on the contractual provisions. Likewise, whether the franchisor may refuse to renew the franchise agreement is, in principle, also determined by the terms of the franchise agreement. However, as a franchise agreement is concluded with the intent that franchisees will conduct ongoing business operations and franchisees often make substantial and long-term investments, the franchisor's refusal to renew may be restricted under general provisions of the Civil Code (such as the principle of good faith, public policy, or the prohibition of abuse of rights) in order to protect the franchisee's legitimate expectation of contract continuation. In the event that the franchise agreement is not renewed, or is terminated or expires, the franchisee is not automatically entitled to compensation; such entitlement, if any, depends on the contractual terms. If a franchisee makes substantial investments in reliance on the expectation of a reasonably long-term contract, and the franchisor refuses to renew the agreement after a short term, such refusal may be considered unfair on the grounds of a breach of the duty of good faith or other similar principles, in which case the franchisee may have a potential claim for damages.

22. Are there any mandatory termination rights which may override any contractual termination rights? Is there a minimum notice period that the

parties must adhere to?

There are no mandatory termination rights which may override any contractual termination rights. Likewise, there is no prescribed minimum notice period that the contracting parties are required to observe.

23. Are there any intangible assets in the franchisee's business which the franchisee can claim ownership of on expiry or termination, e.g. customer data, local goodwill, etc.

Upon termination or expiration of the franchise agreement, the franchisee ceases to be part of the franchise system, and all rights as a franchisee, including the right to operate the store or business, are extinguished. Where the franchisee has obtained personal information from customers on its own, or where the franchisor has obtained personal information from customers with an explicit indication that such information will be jointly used with the franchisee and the franchisee has used such information accordingly, the franchisee may assert ownership of such personal information upon the termination or expiration of the franchise agreement. However, the franchisee may not use the personal information beyond the purpose explicitly stated at the time of collection. As it is generally the case that the franchisee obtains and uses personal information solely for the purpose of operating the franchise business, the franchisee would not be permitted to use such information after the termination or expiration of the franchise agreement. Apart from personal information, the franchisee does not have ownership rights over any other intangible assets.

24. Is there a national franchising association? Is membership required? If not, is membership commercially advisable? What are the additional obligations of the national franchising association?

In Japan, the JFA (see answers to Question 4 above) serves as an industry organization for the domestic franchise sector. Membership is voluntary; however, it is composed primarily of leading Japanese companies operating franchise businesses, and the membership is commercially recommended. To promote the proper development of franchise systems, the JFA has established and published the JFA Code of Ethics, the JFA Voluntary Disclosure Standards (see Question 4 above), and the Guidelines for Preparation of Statutory Disclosure Documents titled "Summary and Overview of

the Franchise Agreement" (see Question 4 above). Franchisors that join the JFA are required to comply with the JFA Code of Ethics and are obligated to submit to the JFA the statutory disclosure document provided to franchisees.

25. Are foreign franchisors treated differently to domestic franchisors? Does national law/regulation impose any debt/equity restrictions? Are there any restrictions on the capital structure of a company incorporated in your country with a foreign parent (thin capitalisation rules)?

Where a franchise agreement is governed by Japanese law, a foreign franchisor is not treated differently from a domestic franchisor. There are no restrictions under Japanese law or regulations regarding debt-to-equity ratios or capital structure of franchisors. However, Japan's thin capitalization rules provide that if a Japanese corporation with a foreign parent company makes interest or similar payments to the foreign parent and the debt exceeds three times the corporation's equity, the interest on the excess portion is not deductible for corporate tax purposes.

26. Must the franchise agreement be governed by local law?

There is no regulation requiring that a franchise agreement be governed by Japanese law. However, even if the governing law is foreign law, mandatory provisions of Japanese law including the Retail Business Promotion Act, the Antimonopoly Act, and the Labor Standards Act, will still apply to the franchise relationship.

27. What dispute resolution procedures are available to franchisors and franchisees? Are there any advantages to out of court procedures such as arbitration, in particular if the franchise agreement is subject to a foreign governing law?

Franchisors and franchisees may resort to various dispute resolution procedures, including litigation, arbitration, and mediation. Where the governing law of the contract is foreign law and the courts of Japan are designated as the forum, there is no guarantee that the judges will be familiar with the practices and interpretations of the foreign law. Consequently, the parties must actively and thoroughly present evidence regarding the content, interpretation, and application of the foreign law, which may increase costs due to the need for translations of expert opinions and reference materials concerning the foreign law. In contrast, in arbitration, the parties generally have the freedom to agree on the method of appointing arbitrators, which allows them to select arbitrators qualified in the governing law. This represents an advantage of alternative dispute resolution compared with litigation.

28. Must the franchise agreement and disclosure documents be in the local language?

While disclosure in the Japanese language is not explicitly mandated, from the perspective of ensuring adequate disclosure of information to franchisees, disclosure should be made in Japanese, unless there are special circumstances such as the franchisee's request for disclosure in a language other than Japanese.

29. Is it possible to sign the franchise agreement using an electronic signature (rather than a wet ink signature)?

It is possible to execute a franchise agreement using an electronic signature instead of a wet ink signature.

30. Do you foresee any significant commercial or legal developments that might impact on franchise relationships over the next year or so?

No significant commercial or legal developments that are likely to affect franchise relationships are anticipated over the next year or so.

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