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China Legal Update and Newsletter



About Erex Chen:

Erex Chen is managing partner of Mylink Law Office.

Erex Chen graduated from East China University of Politics and Law (L.L.M.).

Erex Chen has rich experience in corporate, employment, intellectual property, international trade and tax. Erex Chen provides daily legal service for foreign-invested companies and oversea companies, as well as large and media-sized Chinese companies, including investment and trading projects in China by foreign-invested companies and oversea companies, and outbound investment by Chinese companies. Erex Chen understands well the differences in business environments and cultures between China and international markets, and provides timely and efficient service to clients with various backgrounds.

Erex Chen works for clients including global top 500 enterprises, as well as well-known domestic and international companies in the manufacture, chemical, trade, software, finance, restaurant, consulting, architecture designing and education industry.

Erex Chen has excellent command of both Chinese and English.

What can be done if no cooling-off period is agreed?

Question

Cooling-off period refers to a period agreed by the franchisor and the franchisee in a Franchise Agreement where the franchisee is allowed to unilaterally terminate the Franchise Agreement with no cause. The purpose of such cooling-off period is to prevent any impulsive investment behavior by the franchisee by giving the franchisee right to go back, so that to protect the interest of the franchisee.

However, for the franchisor who has gained the expected benefit from Franchise Agreement, cooling-off option is obviously not a good thing. In the event a cooling-off period has been agreed in the Franchise Agreement, for sure no dispute may arise. But in many cases, such cooling-off period is either ignored by the franchisor due to hastily preparation of the Franchise Agreement, or is omitted intentionally by the franchisor. Then the question is, if no cooling-off period is ever agreed in the Franchise Agreement, what is the impact on the franchisor?

The right of unilaterally terminating the Franchise Agreement based on the cooling-off option is still available to the franchisee

The right of terminating by the franchisee based on cooling-off option is a statutory right granted to the franchisee by the law. Therefore, even if no specific clause is agreed in terms of cooling-off period, the franchisee is still entitled to exert this right.

Under the circumstances of no specific agreement on cooling-off period, the right to terminate the Franchise Agreement by the franchisee is subject to the extent the Franchise Agreement is performed, as well as laws and regulation. Such restriction includes:

Time length of cooling-off period

In most cases, if a cooling-off period is considered by the parties, due to the fact the Franchise Agreement template is usually prepared by the franchisor in advance, more importantly, the franchisor is reluctant to see the losing of contract benefit due to cooling-off option, such agreed cooling-off period is quite short, which could be 1 month or even several days. Despite of this, the agreement on short cooling-off period is legal binding.

In the event no cooling-off period is agreed by the parties, if the franchisee intends to terminate the Franchise Agreement within a certain period after the signing of the Franchise Agreement replying on cooling-off option, is there any limitation to such period under the law? So far we don't see any implied cooling-off period set by the law. Thus, whether the franchisee is allowed to terminate shall be decided on a case-by-case basis, in consideration of the performance of the Franchise Agreement.

The extent the Franchise Agreement is performed is the key element to determine whether the franchisee enjoys the right to terminate based on cooling-off option

The following aspects shall be considered to decide whether the franchisee is still allowed to terminate:

1. Whether the franchise resource has been provided to the franchisee by the franchisor

Usually according to the Franchise Agreement, the franchisor shall provide licensing of intellectual property (such as trademark) and other franchise resource (such as operation handbook etc) to the franchisee. Before the franchise intends to terminate the Franchise Agreement, whether such licensing of IP and franchise resource has been provided to the franchisee is a factor which shall be taken into consideration.

2. Whether the franchisee has started the operation

Before and after the Franchise Agreement is signed, the franchisee usually has started to prepare the operation issues such as site selection, decoration, store opening etc. At the time the franchisee terminates the Franchise Agreement based on cooling-off option, if he has actually opened the store for operation and made use of the franchise resource, normally the termination shall not be a legal one any more.

3. Whether the franchisor has provided relevant franchise service

Besides the provision of franchise resource, the franchisor usually needs to provide service including site selection, marketing, personnel training etc. for the franchisee. Whether these service has been provided when the franchisee terminates based on cooling-off option shall be one factor which shall be taken into consideration.

Suggestions for the franchisor

From the perspective of the franchisor, to avoid his contract interest is seriously damaged or affected due to the franchisee's cooling-off option, we suggest the following measures to be taken:

1. To actively include the cooling-off period into the Franchise Agreement. As discussed, the franchisor can opt to include a short cooling-off period such as 2 weeks so that this period elapses very quickly after signing of the Franchise Agreement.
2. After signing of the Franchise Agreement, the franchisor shall actively provide franchise resource and meanwhile, keep the receipt of the franchisee in relation to the provision of the franchise resource.
3. After signing of the Franchise Agreement, the franchisor shall actively cooperate with the franchisee to select site and start operation asap;
4. To avoid the full refund of paid franchise fee due to the termination of the Franchise Agreement by the franchisee, it is recommended that additional clauses can be agreed in the

