

Franchising in Russia: a best practice guide

Russia offers great potential for franchising, but local knowledge is key if brand owners are to avoid costly missteps

Any company that has decided to expand abroad must acknowledge that each country has its own specificities and customs. For this reason, brand owners must understand the basic legislative framework of the franchising industry in a foreign country before expanding there. This includes being aware of general legislation on commercial contracts, adequate company law and IP legislation, as well as the effective enforcement of rights guaranteed by such legislation. This article provides a best practice guide to franchising in Russia.

How a franchise agreement should look

Under Russian legislation, a franchise agreement is referred to as a 'commercial concession agreement' (Chapter 54 of the Civil Code). The essence of the commercial concession agreement is that, by entering into it, one party (the rights holder or franchisor) undertakes to afford the other party (the user or franchisee) the right to use a set of rights in a trademark, brand book, slogan or design know-how, for a certain remuneration.

Only parties engaged in business activities – whether commercial legal entities or individual entrepreneurs – can be parties to such agreements.

Besides the transfer of a set of rights, the franchisor generally also assumes non-standard obligations, which cannot be cancelled. These aim to support the franchisee by providing it with initial technical and commercial documentation – as well as other information – and instructing its employees.

The law of the country applicable to the transaction also applies to the form of the agreement itself (eg, written, oral or notarial). However, compliance with the law on contractual form prevents any such transaction from being held invalid. This means that when concluding an agreement in Moscow, for example, provided that the parties comply with all the requirements of Russian legislation regarding the form of the agreement, the transaction cannot be held invalid due to its form. Therefore, the parties should ensure that the place of the agreement commission is indicated in the agreement itself.

AUTHOR
EKATERINA
SMIRNOVA

In Russia, the franchise agreement must be concluded in writing. Failure to comply with this requirement will render the agreement invalid.

Further, if a transaction in Russia or the occurrence, transfer, restriction or termination of rights under such a transaction is subject to mandatory state registration, then the form of the transaction is also subject to Russian legislation. According to Article 1028 of the Civil Code, the granting of rights under a franchise agreement must be registered with the Russia Patent and Trademark Office (Rospatent). The same rule applies to the amendment and termination of agreements. This is important as franchise agreements or the transfer of rights under them are not subject to registration in all countries.

Registration takes an average of two to three months. Applicants must submit a set of documents to Rospatent, along with a registration application, and are subject to a fee.

When drafting a franchise agreement, practitioners should keep in mind that if the law of the country in which the agreement is executed requires the registration of the agreement or of any rights transferrals under it, the registering authority will require a translation of the documents into its working language (eg, Russian when registering at Rospatent).

Determining the applicable law

As in many countries, when concluding a transaction in Russia, foreign parties may choose the law that will govern the relationship between them. To do so, they must state directly in the agreement which country's legislation will govern the agreement as a whole or its individual parts.

For example, if the parties to a franchise agreement originate from the United States and Russia, they have the right to directly establish that the agreement is subject to US regulation. Alternatively, they can select the law of a third country (eg, France) as the applicable law. However, it is only reasonable to choose the law of the country in which the agreement is due to be applied or the law that the parties trust the most. If the US party is the franchisor, then it will likely have greater bargaining power and will likely choose US federal or state law



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as the applicable law. However, if the parties choose a Russian state court as the authority to settle disputes, then choosing US law will appear unjustified, as applying the norms of foreign legislation in Russian courts will be difficult and ineffective.

If the applicable law is not explicitly defined in the agreement, the parties will be governed by international private law, including conflict of law rules and international agreements between the origin states of the parties to the contract. Under the norms of international private law established in Part 3 of the Civil Code (Part 6 of Article 1211), the law of the country in which the franchisee is permitted to use the set of exclusive rights bestowed by the franchisor will apply to the franchise agreement. If the franchisee is permitted to use these rights in several countries at the same time, the law of the country in which the franchisor resides or in which its principal place of business is located will apply.

When choosing the applicable law, the parties should note that their choice will regulate relations between the parties to the agreement only. Issues relating to, for example, the violation of IP rights by a third party will be governed not by the franchise agreement or the chosen law, but rather by the law of the country in which the violation occurred.

The need for registration

Transferring the right to use a trademark to a franchisee is a binding legal requirement to establish a franchising relationship.

If a foreign party transfers the rights in a trademark, then the mark must already be registered in Russia. Parties often forget about this requirement.

Practitioners should bear in mind that the registration of a trademark in Russia usually takes at least 12 months and that this timeframe should be included in the franchising road map.

One question that will often arise is: is it possible to transfer rights in other intellectual property without transferring rights in a trademark? The answer is yes, but this will qualify as a licence agreement.



The registration of a trademark in Russia usually takes at least 12 months and this timeframe should be included in the franchising road map

Transferring IP rights and the differences in protection

A franchise agreement must specify all details pertaining to the intellectual property in which the rights of use will be provided to the franchisee. For example, with regard to a trademark, the agreement must state the date of its registration and the registration number in the Rospatent register. With regard to a computer program or database, the agreement must state its name, purpose and volume.



With regard to information, listing is key. This can be done by a direct reference to documents that contain certain information (eg, a brand book, user manual or commercial secret provision). It is also recommended that the franchise agreement outline the limits of use of such property, namely:

- the types of permissible use (eg, copying, placement on goods and in the provision of services, introduction into circulation or offering for sale);
- the purpose of use (eg, provision of services, advertising or marketing);
- the term of use; and
- the territory of use.

It is also worth touching on the problem of different legal regulations regarding the protection of IP rights that are transferred as part of a franchise agreement. The fact is that there may be cases where an object is recognised as protected intellectual property in one country but not another. This is particularly the case when it comes to rights in know-how (trade secrets) and utility models, as there is no common understanding of protection in relation to these rights among different countries.

For example, in many jurisdictions (eg, Japan and the United Kingdom), know-how is not recognised as a type of intellectual property. Moreover, different countries use different terms for this concept, including ‘undisclosed information’, ‘trade secrets’ and ‘manufacturing secrets’.

In Russia, know-how is protected as an independent IP right provided that it is subject to confidentiality.

Similarly, in many countries, utility models are not protected as patents but rather as designs. This means that, if the use of a utility model and the liability for violating the obligations of such use are governed by the parties to a franchising agreement, in the case of non-

In 2017 McDonald's revealed plans to expand its network in Russia with 50 more restaurants

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contractual use of the model (eg, by a third party which is not a party to the agreement or after the termination of the contract), the possibility of protection may be questionable in a country in which the protection of utility models is not provided for by law.

For example, Article 1231 of the Civil Code stipulates that “in the territory of the Russian Federation exclusive rights established by international treaties of the Russian Federation and this Code are in effect”. The code does not provide for the possible protection of a trade secret that originates from the territory of a foreign state. Therefore, in order to recognise the protection of the trade secret in Russia, there must be a special international agreement on the protection of trade secrets. In the absence of such an agreement, the protection of foreign know-how as an IP right in Russia is seemingly impossible.

To resolve this issue, rights holders may initially design their know-how in Russia, then classify it and subsequently transfer the rights in it under a franchise agreement.

If a franchisee using the set of rights granted to it under a franchise agreement creates new intellectual property during the course of the agreement, it is strongly recommend that the issue is settled directly in the agreement. For example, the agreement should state that the exclusive rights in all property created in this way belong to the franchisor from the moment of their creation and that the franchisee is granted a licence.

Ending the relationship

When drawing up the agreement, the parties should also consider how they will later part. To this end, the agreement may provide the terms and conditions for out-of-court repudiation by the parties. This is often appropriate in cases where one of the parties

CHECKLIST FOR SUCCESS

Top tips for success	Check
The trademark is registered in Russia.	<input checked="" type="checkbox"/>
The franchisor has the right to transfer the right to use the trademark in Russia in favour of third parties.	<input checked="" type="checkbox"/>
The franchisor and franchisee are both engaged in commercial activities (eg, a legal entity or individual entrepreneur).	<input checked="" type="checkbox"/>
The agreement is made in writing, including a Russian translation.	<input checked="" type="checkbox"/>
The agreement has been filed with Rospatent for registration.	<input checked="" type="checkbox"/>
The agreement includes a clause on the applicable law and court.	<input checked="" type="checkbox"/>
The agreement clearly defines the list of objects transferred to the franchisee and the conditions and limits of their use (ie, a set of rights).	<input checked="" type="checkbox"/>
The agreement determines the amount of remuneration.	<input checked="" type="checkbox"/>
The agreement clearly defines the territory of use of the set of rights.	<input checked="" type="checkbox"/>

substantially violates the terms of the franchise agreement. In such circumstances, the agreement should outline what the parties understand to be a gross violation (eg, failure to pay remuneration, derogation from the franchisor's instructions and failure to undergo mandatory training by the franchisee's employees).

It is also important to ensure that – on termination of the agreement – the franchisee returns all manuals, documentation, templates and models, access keys to worksites and social media groups. Establishing fines for non-performance may serve as a stimulus to fulfil such duties.

In addition to the terms of unilateral repudiation, the franchise agreement can also provide for conditions on the franchisor's priority redemption rights to the franchisee's assets in case of termination of the agreement.

Further, the parties should consider which court to appeal to in the event of a dispute. Similar to determining the applicable law, the parties to an international franchise agreement are entitled to directly determine in what order and by which authority their disputes will be resolved. This may be a state court of one of the parties or a non-state court (eg, an international commercial arbitration court such as the International Chamber of Commerce International Court of Arbitration, the London Court of International Arbitration or the Arbitration Institute of the Stockholm Chamber of Commerce).

The term of consideration of a dispute in the first instance in a Russian state court can be between six and 12 months. Practitioners should keep in mind that it is obligatory to send a letter of action to the other party before going to court in Russia.

It is also important to remember that the termination of a franchise agreement must be registered with

Rospatent. On termination, the former franchisee loses the right to use the set of rights previously granted to it, including know-how, trademarks and designs. Consequently, after the termination of the agreement, use of such property without the franchisor's consent may result in the franchisee being held liable for the illegal use of intellectual property and the franchisor may seek monetary compensation and prohibit any further use of such objects.

Contractual best practice and market expectations

An effective franchise agreement should clearly set out the subject matter of the agreement and the amount of remuneration or the procedure for determining this amount. Under the requirements of the law, such an agreement can only be remunerated.

It is also important that, in accordance with Russian law, the franchisor bears subsidiary liability for the requirements imposed on the franchisee with regard to the quality of the goods, works or services sold, performed or rendered under the agreement. As the manufacturer of the products, the franchisor is jointly liable with the franchisee.



The termination of a franchise agreement must be registered with Rospatent

The law also provides for the inclusion of terms in the franchise agreement that restrict the legal capacity of the parties, which is an exception to the civil law principle of the inadmissibility of legal incapacity. As such, the following terms may be included in the agreement:

- Competition restriction: the franchisee must not compete with the franchisor in the same territory covered by the franchise agreement; the franchisee waives the right to obtain similar IP rights from the franchisor's competitors.
- Restriction of the freedom to sell goods or provide services: the franchisor sets specific prices for the sale and resale of goods, services or the performance of works. The franchisor determines a particular territory of business activity and the franchisee is prohibited from selling similar goods, performing similar work or providing similar services using the means of other rights holders. The franchisee must also coordinate with the franchisor on the location of the premises to be used in the exercise of the exclusive rights provided by the agreement, as well as the external and internal design of these premises. Indeed, the list of possible restrictions is unlimited.

Ultimately, it is vital that brand owners are familiar with the specifics of the legislation of a country in which they intend to commence business. In any case, advice from local lawyers should be obtained well in advance. **WTR**



Ekaterina Smirnova is head of intellectual property and information technologies at Kachkin & Partners
ekaterina.smirnova@kachkin.ru