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The International Comparative Legal Guide to:

Franchise 2015

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A practical cross-border insight into franchise law

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Russian law does not use the term "franchise". Instead, the term "commercial concession" is applied to define the franchise relationship. According to Article 1027 of the Russian Civil Code, under the contract of commercial concession one party (rights holder) shall undertake to grant the other party (user), for a remuneration and for a definite or indefinite term, the right to use in the business of the user a set of exclusive rights owned by the rights holder, including the trademark rights, service mark rights, and other intellectual property rights, such as the trade name rights and trade secret (know-how) rights.

The key element of the "contract of commercial concession" (hereinafter – "franchise agreement") is a registered trademark. In the absence of the registered trademark the contract may not be regarded or interpreted as a franchise. Other elements, including but not limited to trade names, copyrights, patents and trade secrets (know-how), may be included in the scope of the franchise agreement in addition to the registered trademark. The law only gives examples of such elements, therefore, the list of franchiseable objects is not exhaustive, which means that any other IP subject matter (*e.g.* software and databases) may fall under the scope of the franchise transaction (aside from the registered trademark).

1.2 What laws regulate the offer and sale of franchises?

Franchises are specifically regulated by the Russian Civil Code (Chapter 54). The general provisions of the Russian Civil Code, especially the ones that govern general aspects of national contract law, may also apply to franchise relations. The ongoing franchise relationship may also be regulated (and affected) by the local laws on intellectual property and information technology, consumer protection and data protection, advertising and promotion, competition and commercial law, labour and employment, real estate and property law, tax and currency control, as well as other Russian laws and regulations.

1.3 Are there any registration requirements relating to the franchise system?

Every franchise agreement, even if governed by a foreign applicable law, shall be made in writing. In addition, every franchise transaction contemplated by the franchise agreement must be registered with the Russian Federal Service for Intellectual Property (hereinafter – "Rospatent"). A franchise agreement that is not registered with Rospatent will be regarded as incomplete (Article 1028 (2) of the Russian Civil Code). Hence, in order to close the franchise transaction involving the Russian element, it is imperative to obtain the registration of the same.

Russian law does not set a specific limitation period within which the franchise transaction has to be registered with Rospatent. However, the sooner the registration of the franchise transaction is reached, the better the franchise agreement will serve for the contracting parties as a binding document from the point of view of validity and enforceability.

1.4 Are there mandatory pre-sale disclosure obligations?

Pre-sale disclosures are not mandatory under Russian law. Nor does Russian law require the franchisor to provide disclosure updates within the term of franchise agreement. The law only states that the franchisor shall provide technical and commercial documentation and any other information necessary for the franchisee (and its employees) to be able to implement the franchising activities under the franchise agreement; and this may not necessarily represent the pre-sale disclosure in all relevant senses. At the same time, pre-sale disclosure obligations may be established on an optional basis for the purpose of compliance of the general civil-law principle of "good faith" that is recognised for every business transaction (whether national or international).

1.5 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Pre-sale disclosures, although not mandatory under Russian law, can be made on the terms defined by the contracting parties and extended to sub-franchises and even onward to sub-sub-franchises. A separate agreement on that issue may be concluded by the parties, as the case may be in practice. Usually, sub-franchisors and sub-sub-franchisors will be required to make the necessary pre-sale and contractual disclosures under the relevant contracts in cross-border deals involving a Russian element.

1.6 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The format of disclosures is not prescribed by Russian law. Hence, the

contracting parties are free to use and be guided by the documents used in international franchise practice. In any event, the relevant disclosures underlying the franchise relationship shall be sufficient for the other side to exercise its contractual rights and obligations. The issue of disclosure updates will normally be subject to agreement between the parties. Under the common rule of law, the franchisor must render ongoing technical and consultative assistance to the franchisee, unless the contract provides to the contrary.

1.7 Are there any other requirements that must be met before a franchise may be offered or sold?

Aside from the pre-sale disclosure (that is optional) and Rospatent registration (which is imperative) requirements, the franchisor may also wish to provide the appropriate brand guidelines and operations manual to the franchisee. Although this is not mandatory under Russian law, the provisions related to the transfer of these materials will be normally regulated by the franchise agreement. There are no other requirements or formalities that must be met nowadays before a franchise is launched in Russia. In the past, franchise transactions had to be registered with the Russian Federal Tax Service (in addition to Rospatent registration).

1.8 Is membership of any national franchise association mandatory or commercially advisable?

Membership of a national franchise association is not mandatory in Russia; nevertheless, it may be regarded as commercially advisable. There is a local non-profit public organisation called the "Russian Franchise Association" (RFA) which helps its members to promote franchising activities in Russia. Although the RFA does not have any regulatory power, it may give certain useful practical recommendations and tips on doing franchising business in the Russian market. More information about the RFA can be found on their official website: www.raf.ru.

1.9 Does membership of a national franchise association impose any additional obligations on franchisors?

Membership of national franchise associations may lead to franchisors being obligated to offer franchises through various advertising channels (*e.g.* target websites) of such associations and to participate in different franchising conferences. Other obligations or requirements may be imposed on franchisors by the internal policies of particular associations.

1.10 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

Franchise documents, including the franchise agreement as well as disclosure documents, should be in Russian (or translated into Russian). Rospatent will not accept the franchise agreement if it is filed for the registration of the franchise transaction without a Russian translation. In practice, a bilingual version of the franchise agreement is usually prepared and filed in cross-border deals in case the parties wish to deposit and store the original contract with Rospatent. Alternatively, a bilingual statement of franchise may also be prepared and filed with Rospatent in order to avoid the disclosure of the original franchise agreement. Sometimes, franchise and disclosure documents are produced in a foreign language (*e.g.* English) and supported by a certified Russian translation.

2 Business Organisations Through Which a Franchised Business can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in Russia?

For the most part, there are no legal restrictions on non-nationals in respect of the ownership or control of a business in Russia. Indeed, any business, including in the sphere of franchising, should comply with all relevant laws and regulations governing contracts, performance of obligations and the general conducting of business operations.

At the same time, certain areas of investment are of strategic importance to the Russian government to protect the state defence and national security. Hence, a special licence or permission from the government has to be obtained before investing and/or transacting within certain industries (*e.g.* encryption, weaponry, space and aviation). The media and telecoms sectors have certain restrictions in terms of corporate ownership and control as well.

2.2 What forms of business entity are typically used by franchisors?

The principal rule of franchising is that the parties to a contract must be commercial entities (*i.e.* companies or individual entrepreneurs). Non-commercial companies and governmental agencies may not enter into franchise relationships.

Most frequently, limited liability companies will represent franchisors in regular franchise deals providing general corporate and tax benefits. Sometimes, joint stock companies are used in complex franchise transactions (*e.g.* joint venture franchises). Other forms of business entities, such as partnerships, are not very popular in the field of franchising.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in Russia?

A foreign business entity is free to offer and sell a franchise directly or indirectly to a Russian business entity. In other words, the foreign business entity (franchisor) may conclude a franchise agreement with the Russian business entity (franchisee), or engage another foreign partner (franchisee) to sell a sub-franchise to the Russian company (sub-franchisee) under a sub-franchise agreement. There is no legal requirement or imperative to set up a new special Russian business entity as a pre-condition for performing franchising activities in Russia.

If a foreign franchisor is willing to open a new business entity in Russia to use it as a "corporate hub" for further franchise transactions, it is possible, for example, to form a limited liability company by registering the same with the Russian Federal Tax Service. In this case, the articles of association, decision of the founders and other documents must be produced and submitted in due course. In addition, a bank account must be opened by the applicant. Finally, registration has to be secured with the Russian Federal State Statistics Service and with local Social Funds. In contrast to joint stock companies, limited liability companies may benefit from the process of incorporation and publicity requirements.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Competition is mainly regulated by the Russian Law on Protection of Competition. It prevents monopolistic (anti-competitive) activities, including "cartels", stops abuse of dominance and prohibits unfair competition. The law basically allows "vertical" agreements, including franchise agreements, whether made between foreign companies, or domestic and foreign persons, or between domestic entities.

According to Article 1033 of the Russian Civil Code, the franchise agreement may contain different restrictions and covenants for the parties. Specifically, the franchisor may be obliged not to offer and sell the same franchises to other persons on the territory assigned to the franchisee, or it may be obliged to refrain from carrying out similar activities (*e.g.* related to the use of the franchised system and IP rights) on the franchised territory. The franchisor may impose a non-compete covenant on the franchisee which may be extended to the franchised territory and IP rights. The franchisor may also impose an obligation on the franchisee to refuse to enter into similar franchise agreements with competitors of the franchisor. The franchisee may be obliged to sell goods or provide services at the prices fixed by the franchisor and refrain from selling similar goods or providing similar services from competitors of the franchisor. The franchisee may also be obliged to sell goods exclusively within certain contracted territory. The franchisee may be obliged to get approval for the location as well as the interior or exterior of the contracted commercial premises for implementing franchising business.

Theoretically, the restrictions and covenants which are incorporated in the franchise agreement may be declared invalid by the antimonopoly body (or other interested person) if they are found to be contradictory to the antimonopoly laws, subject to the relevant market condition and economic status of the parties. Currently, the standard contractual restrictions and covenants on the parties, which are provided in franchise agreements and made in line with Article 1033 of the Russian Civil Code, are acceptable from the antitrust standpoint, and there has been no case so far where a particular franchise agreement has been challenged in view of the breach of national competition laws.

As mentioned above, the Russian Law on Protection of Competition prohibits unfair competition. Hence, dissemination of false information which may damage the operating business entity is not allowed. The law also bans the marketing of goods if intellectual property subject matters affixed to such goods are unlawfully or illegally used. It also prevents unfair competition in cases where other persons acquire and use intellectual property rights in bad faith.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term within which a franchise agreement must be made (effective). The franchise agreement may be concluded within a definite or indefinite term depending on the business needs, project specifics and parties' negotiations.

In particular, the contract may provide for a specific term (*e.g.* 10 years), or clearly state that it stays valid during the period of protection of the franchised trademark(s) and other IP rights which are licensed under the franchise agreement. If the term of the franchise agreement is not defined by the contract, the franchise shall be regarded as granted and effective for five years (starting from the corresponding registration date).

3.3 Is there a maximum permitted term for any related product supply agreement?

There is no maximum permitted term for any related product supply agreement. The term of the underlying product supply agreement may repeat the term of the franchise agreement or be even shorter (if necessary). Again, this will be subject to contract in each particular deal or project.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

As follows from Article 1033 of the Russian Civil Code (*please see question 3.1 above*), the franchisee may be obliged by contract to sell goods or provide services using the prices fixed by the franchisor. However, the fixing of prices, including minimum resale prices, will always be under the supervision of the Russian Federal Antimonopoly Service – a governmental agency that is responsible for observance of competition-related laws and regulations. This agency may, within the scope of its competence, tackle any anti-competitive practices, if they entail or may entail the fixing or support of prices (tariffs), discounts, mark-ups (additional payments) and/or extra charges. Therefore, if the Russian Federal Antimonopoly Service finds the contractual provision on the "minimum resale price" to be in contravention of the antimonopoly laws, subject to the relevant market condition and economic status of the parties, such clause may be recognised as invalid under the claims of the Russian Federal Antimonopoly Service.

3.5 Encroachment - are there any minimum obligations that a franchisor must observe when offering franchises in adjoining areas or streets?

The territory (region, city, street, address, etc.) may or may not be specified in the franchise agreement. If the contract is silent on the territory, the franchise will be regarded as granted and effective in the whole territory of Russia. If the contract specifies a certain territory, the franchise will be valid against such (contracted) territory.

At the same time, while the franchisor reserves the right to offer and sell non-exclusive franchises to an unlimited number of partners within one and the same contracted territory, it may not be the case with the exclusive franchises. In other words, the franchisor can be restricted from trading the exclusivity to more than one partner for the same franchised territory.

The question of whether the franchisor may operate in the same contracted territory (together with the exclusive franchisee) shall remain the subject of a contract, as the law does not set forth any restrictions in this regard.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

In-term and post-term non-compete restrictive covenants may be enforceable depending on the relevant wording in the franchise agreement. Non-solicitation clauses will not be enforceable in Russia.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

A trademark will be protected on a national basis after it has been registered with Rospatent. Russia is a signatory to the Madrid Agreement as well as the Madrid Protocol, therefore an international trademark registration (designating Russia) will also be protected. An unregistered mark, or mark-in-use, will not be protected, unless it has obtained "well-known" status through the Rospatent agency.

The duration of the national trademark registration procedure is approximately one year. The examination procedure includes formal and substantive examination. When the trademark is registered it is entered into the Trademark Register and will be valid for 10 years. Trademark registration may be renewed for another 10 years an unlimited number of times.

Any words, pictures, three-dimensional configurations and other marks may be registered as trademarks. The registration of non-traditional marks, such as sounds, colours and smells, is not prohibited by law. To be registered, a mark has to be new and distinctive. Distinctiveness may be inherent or acquired.

Use of the mark does not have to be claimed before registration. Further, no proof of use has to be submitted before the trademark application is filed. The owner shall start using the trademark within three years after its registration. If the mark is not used during the three-year term upon the trademark's registration, any interested person may apply for cancellation of trademark protection on the grounds of its non-use.

Infringement of trademark rights leads to liability and sanctions in accordance with Russian law. The trademark owner is entitled to commence administrative, civil or criminal proceedings against the infringer(s) depending on the circumstances surrounding the matter and remedies available.

Trademark registration will be the first key element in every franchise transaction.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Any business-critical and confidential information may be protected as know-how. Know-how shall not be registered; nevertheless, the owner must undertake certain reasonable measures to maintain the confidentiality of the relevant information. If such measures are not implemented, know-how protection will not be afforded to the confidential information.

One of the legal ways to acquire know-how protection would be to implement the so-called "trade secrets regime", as it is described in the Russian Law on Trade Secrets. Specifically, the owner has to properly identify the confidential information, limit access to the confidential information (by establishing the appropriate procedure for dealings with the same), affix the notice "Trade Secret" to the medium where the confidential information is stored (along with the owner's details), and follow the other steps required by the mentioned Law. If one of these steps is ignored or omitted by the owner of the confidential information, the "trade secrets regime" will not be introduced, and as a result the know-how protection will not be afforded.

Know-how will be protected for as long as it is kept secret by its holder. When the confidentiality is lost, the exclusive rights lapse immediately.

Many franchise agreements will have know-how licences contemplated by such contracts, aside from the trademark licences granted, as the transfer of confidential information is usually regarded as the most important part of every franchising business.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright subsists in scientific, literary and artistic works fixed in any tangible medium of expression, regardless of benefits, purposes or methods of their expression. To be copyrightable, a work of authorship shall satisfy two fundamental criteria. It must be: (i) creative or original; and (ii) fixed in any tangible medium of expression.

According to Article 1259 (1) of the Russian Civil Code, the following examples of works of authorship can obtain copyright protection:

- literary works;
- dramatic works;
- musical works;
- choreographic works and pantomimes;
- audio-visual works;
- sculptural, graphic and design works;
- photographic works;
- architectural works;
- pictorial works; and
- computer programs.

Also, copyright law protects compilations (*e.g.* databases) and derivative works (*e.g.* translations).

Essentially, copyright vests in a work of authorship from the moment of its creation. There is no need to register or comply with any other formalities to acquire, exercise, transact, franchise, protect or enforce copyright in Russia.

The general duration of copyright protection, which is applicable to all works of authorship, is the lifetime of the author, plus 70 years after her or his death.

Subject to certain "fair use" exceptions, which are precisely defined by the Russian Civil Code, unless authorisation is obtained from the copyright owner, the reproduction and any other use of the copyrighted work constitutes copyright infringement. The absence of an intent to infringe, and ignorance of law, are not defences for copyright infringement.

Most often, operations manuals as well as proprietary software/databases will be covered by copyright. As a result, copyrights vested in such works will be licensed along with trademarks within the scope of many franchise agreements.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The franchisee may file a lawsuit against the franchisor for breach of contract (*i.e.* for violation of contracted disclosure obligations). The franchisee is entitled to seek monetary relief if the court finds that some necessary information or assistance is withheld by the franchisor, or not provided in due course. Damages can be real and circumstantial and must be duly proved to be awarded. If the

franchisee is able to show that failure of conveyance of the required information and/or assistance by franchisor is a material breach of the contract, the franchisee may have an option to rescind the contract. In any event, the enforcement of remedies shall depend on the circumstances surrounding the case and evidence of the breach in question.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading allocated between franchisor and franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

If contractual disclosure provisions are included in the franchise and sub-franchise agreements, the liability for disclosure non-compliance or misrepresentation in terms of data being disclosed shall be allocated in the manner agreed by the respective parties. Theoretically, such liability may be joint or several. Practically, there have been no judgments yet on this issue. Neither are there any legal or judicial limitations on indemnities in this regard.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement?

A franchisor may try to avoid liability for pre-contractual misrepresentation by including certain disclaimer clauses in the franchise agreement. However, in cases where the franchisor commits a material breach of the disclosure provisions, and in the event of losses suffered by the franchisee (due to disclosure non-compliance), the franchisee may bring an action for rescission of the contract and reimbursement of damages. Court practice is rather diverse in this respect.

5.4 Does the law permit class actions to be brought by a number of allegedly aggrieved claimants and, if so, are class action waiver clauses enforceable despite the expense and inconvenience of individual arbitrations?

Russian law permits class actions to be brought by a number of allegedly aggrieved claimants. The legal standing, requirements and causes for such actions, as well as proceedings related to the same, are specifically described in the Russian Arbitrazh Procedural Code. Class actions are now becoming popular in commercial disputes involving corporate aspects and securities (but not in the area of franchising).

The enforceability of class action waiver clauses in franchise agreements may be questionable. Hence, such clauses have to be carefully considered before they are incorporated into the contract.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no legal requirement for a franchise agreement to be governed by Russian law. Under the basic principles of international private law, the contracting parties are free to choose the relevant governing law when entering into a deal (or afterwards). Hence, the franchise agreement may be governed by the applicable foreign law.

In the absence of a choice of law provision in the franchise agreement, the law of the country where the franchisee has been authorised to use the franchised system and IP rights licensed shall be applied (Article 1211 (6) of the Russian Civil Code). At the same time, in cases where such use has been permitted on the territories of several jurisdictions, the law of the country where the franchisor is located or has its principal place of business will govern the parties' relationship under the franchise agreement.

In any event, the law of the country that is more bound up with the contract may be applicable in the event that the nature and terms of the contract, or circumstances surrounding the transaction, clearly evidence such a fact (Article 1211 (9) of the Russian Civil Code).

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

The local courts will enforce orders granted by another country's courts for injunction against rogue franchisees, to prevent damages to the brand and misuse of confidential information. Indeed, a court judgment from another jurisdiction may be enforceable in Russia, provided that recognition and enforcement of the foreign court judgment is stipulated by the relevant international treaty to which Russia is a party, and federal law.

Russia is a signatory to many multilateral and bilateral international treaties for recognition and enforcement of foreign judgments, including the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (hereinafter – "the New York Convention"). Hence, an arbitral award from another jurisdiction that is a signatory to the New York Convention may be enforceable as well.

The Russian Arbitrazh Procedural Code provides certain formal mandatory requirements for recognition and enforcement of foreign judgments and arbitral awards. These include, *inter alia*: (i) effectiveness of the court judgment under the law of the jurisdiction on the territory for which it has been issued; (ii) compliance of the statutory three-year term for filing a motion for recognition and enforcement of the foreign court judgment; (iii) consistency of the foreign court judgment with Russian public policy, etc. If such requirements are not observed in due course, a Russian court may refuse to recognise and enforce a foreign judgment or arbitral award.

In the absence of the relevant international treaty, a Russian court may recognise and enforce a foreign judgment or arbitral award on the basis of the international principle of reciprocity and comity (*comitas gentium*). Although not in the sphere of franchising, there are at least a couple of successful cases, along with the landmark court orders, when foreign judgments have been recognised and enforced in Russia on the basis of the *comitas gentium* principle.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Under the common rule of law, the lease agreement shall be concluded for a term which is defined by the contract. If the term is not defined in the contract, the lease agreement will be deemed

concluded for an indefinite term. In this case, any party may repudiate from the contract under a prior three-month written notice, unless the lease agreement provides for a different term for serving the termination notice.

The real estate lease agreement involving the lease of commercial property can be short-term or long-term depending on the business needs, project specifics and parties' negotiations/arrangements. If the contract is short-term (*i.e.* made for a period less than one year), the lease agreement will not be subject to registration. If the contract is long-term (*i.e.* made for a period of one year or more), the lease agreement will be subject to registration and effective from the corresponding registration date. Both, short-term and long-term lease agreements, must be in writing.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Although the lease agreement is not dependent (binding) on the franchise agreement, as it is an individual contract, the concept of conditional lease assignment may be enforceable under Russian practice. If the franchisee/tenant fails on its obligations under the lease, the franchisor may assume its rights and obligations in due course. In this case, a trilateral assignment agreement will have to be made between all parties to effectuate the substitution. At the same time, if the tenant has been performing its obligations over the lease in a timely and proper manner, such tenant will have a pre-emptive legal right to conclude a lease agreement for a new term (the so-called "right of first refusal").

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

In the context of commercial property, there are no restrictions on non-national entities holding a real estate interest or being the sub-lessors in real estate transactions. Generally, foreign entities have the same scope of rights and guarantees as national persons in Russia.

The following restrictions may apply to foreign nationals:

- they are not entitled to own land/plots located alongside national borders (however, they are able to lease land/plots located alongside national borders);
- they are not entitled to own agricultural land plots (this restriction also applies to Russian companies in which over 50% of the authorised capital belongs to foreigners; however, they are able to lease agricultural land plots); and
- they are not entitled to enter into transactions establishing control over businesses of strategic importance (*e.g.*: aerospace businesses and legal monopolies; military and nuclear; and media and telecoms), without prior permission or licence from the government (*please see question 2.1 above*).

The other restrictions for foreigners may be implemented in the future.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease of a particular location)?

Basically, there are two main types of rights on the basis of which real estate may be held under Russian law: (i) an ownership right (the right to possess, use and dispose of real estate); and (ii) a lease right (the right to possess and use real estate in accordance with the terms agreed with the owner). In addition, there are a number of real estate encumbrances granting their beneficiaries a limited right to use the real estate, which include, *inter alia*, mortgages, trust management, easements or servitudes, and concession agreements.

Owners of buildings enjoy an exclusive right to purchase the underlying publicly owned land. The transfer of title to the real estate normally causes the automatic transfer of rights to the land plot under the subject real estate (even if it is leased). Lease agreements may be concluded in respect of the "future" properties and stay valid in case of change of ownership.

The commercial real estate market is well-developed and very profitable in Russia. Premises located in the cities of Moscow and Saint Petersburg are in very high demand. The average rental rates remain quite stable, although due to inflation there has been a small rental rate increase (about 5-7%) over some real estate objects in the year of 2014. The maximum rental rates for prime, class "A" spaces or premises are now available at $1,200-$1,500 per square metre, per year (exclusive of VAT and operating expenses).

In practice, the parties to real estate lease agreements will often use the "security deposit" instrument to secure the tenant's obligation to enter into the lease agreement and/or pay rent. "Key money" and periodic rental payment schemes are both operable in terms of real estate transactions. Initial rent-free periods are also being tested. In most cases, long-term real estate lease agreements will contain clauses providing for periodic reviews of rental payments pertinent to the changes in the landlord's property maintenance expenses.

Russian law requires that transactions with real estate located in Russia shall be governed by Russian law.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Under Russian law, it is possible to create an obligation for the franchisee to sell goods or provide services exclusively within the contracted territory. At the same time, the relevant clauses in the franchise agreement obliging the franchisee to sell goods or provide services solely to the customers located or residing in the contracted territory, shall be void (Article 1033 (2) of the Russian Civil Code). In other words, as long as the franchisee restricts its franchising activities to its own (contracted) territory, it is free to sell goods or provide services to different customers from all over the world. Therefore, such provision, if included in the franchise agreement, may be unenforceable.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no statutory limitations on the franchisor to require the franchisee by contract to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. In this case, the procedure for transfer of domain names should be clearly described in the contract.

Further, any use by the franchisee of the trademark (or similar mark) on the Internet or under a similar domain name, upon termination or expiration of the franchise agreement, may lead to trademark infringement and other penalties established by the law and the contract. Unless assigned in an amicable (non-judicial) manner, domain names may be recaptured in the course of civil proceedings through the agency of the competent court. UDRP proceedings are not effective for .RU, .SU and .РФ domains.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights that one might typically expect to see in a franchise agreement?

The parties are free to use the wording of Article 1037 of the Russian Civil Code to create a valid termination clause in the franchise agreement. Specifically, according to the mentioned provision, any party may terminate a contract at any time if the franchise agreement has been concluded for an indefinite term. Six-month prior written notice is required in this case, unless the contract indicates a different term for advance notification. If the contract provides for a specific period of validity, the parties shall be guided by the terms of the franchise agreement.

Either of the parties to the contract concluded for a definite or indefinite term may repeal the franchise agreement by sending a written notice to the other party 30 days in advance. This option will be available only if the contract provides for the release of monetary compensation.

The franchisor may terminate the franchise agreement if the franchisee produces goods of inferior quality, or the quality of its services does not correspond to what is set out in the contract. The franchisor may also repeal the franchise agreement if the franchisee does not follow the franchisor's instructions and guidance aimed at compliance with the contractual terms related to the use of the franchised system and IP rights licensed. Finally, the franchisor may cancel the franchise agreement if the franchisee fails to settle the franchise fees as provided by the contract.

Termination by the franchisor is also available if the franchisee has failed to remedy the breach within a reasonable term, or has committed another breach within a year upon receipt of the written notice from the franchisor.

The earlier termination of the franchise agreement has to be registered with Rospatent.

If the right to a franchised trademark or franchised trade name is lost for any reason, the franchise agreement will be terminated, unless any similar (effective) right is granted (substituted) by the franchisor. If the franchisor or the franchisee becomes insolvent (bankrupt) the franchise agreement shall be terminated.

10 Labour Laws

10.1 Is there a risk that a franchisee or a franchisee's employees might be treated as the employees of the franchisor, so that the franchisor has vicarious liability for their acts and omissions? If so, can anything be done to mitigate this risk?

The franchisor and the franchisee are separate legal entities, therefore, they have their own labour and employment obligations. The franchisor and the franchisee operate on the basis of a franchise agreement that is primarily governed by civil law (*i.e.* the Russian Civil Code), while the labour and employment relations of the entities operating in Russia are regulated by the Russian Labour Code.

According to the Russian Labour Code, employment relations between the employer and the employee may arise only under a labour agreement. The law also stipulates that the conclusion of civil-law agreements, which, *de facto*, govern the relations between the employer and the employee, are not allowed (Article 15 of the Russian Labour Code). Hence, there is no risk or even likelihood that the franchisee (or the employees of the franchisee) will be held to be the employees of the franchisor in Russia.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the repatriation of royalties to an overseas franchisor?

There are no legal restrictions on the repatriation of royalties or franchise fees to an overseas franchisor. The only requirement is that the franchisee should have an appropriate currency account with the bank to be able to transfer monies in a foreign currency. Further, as has been mentioned above (*please see question 1.3*), the franchise transaction must be registered with Rospatent. Without such registration, the franchise transaction will be incomplete, and the competent franchisee's bank will not be authorised to execute a so-called "passport of the deal". And, in the absence of the "passport of the deal", the contract price cannot be wired to the other side.

The "passport of the deal" is required in cross-border transactions, including in the sphere of franchising, amounting to or exceeding 50,000 USD (or the equivalent thereto). If the contract price is less than the referenced monetary equivalent, there will be no need to open the "passport of the deal", and the competent bank will remit the payment without this particular document, assuming that the grant of a franchise has been duly registered with Rospatent. Usually, it takes three to seven days for the franchisee to obtain the "passport of the deal".

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Foreign franchisors that generate income from the Russian jurisdiction must pay a corporate income tax to the Russian state budget. Royalties payable to a foreign franchisor, when they are not

attributable to the franchisor's permanent Russian establishment, are subject to withholding tax, which has to be remitted by the foreign franchisor's tax agent (*i.e.* the Russian franchisee). The current standard rate of corporate income tax (CIT) is 20% in Russia. However, if the foreign franchisor is incorporated and does business under the laws of a jurisdiction which has signed a "double taxation treaty" with Russia, a reduced (or even zero) CIT rate may be applied. In order to avoid the double taxation regime, the foreign franchisor must provide certified documentary evidence of its permanent establishment in the relevant contracted foreign jurisdiction. Such evidence must be provided to the Russian franchisee before the remittance of the withholding tax.

In addition, the foreign franchisor must charge a value added tax (VAT) on royalties or franchise fees payable by the Russian franchisee. The current standard rate of VAT is 18% in Russia, and it relates only to trademark licences. All other IP licences, such as copyright and design licences, software and database licences, patent and know-how (technology) licences, have been exempted from VAT taxation since 2008. When the foreign franchisor does not have any Russian permanent establishment or Russian branch/representative office, the Russian franchisee will act as its tax agent in order to withhold and remit the VAT (under the trademark licence contemplated by the franchise agreement) to the Russian state budget. In such a case, the amount of royalties payable to the foreign franchisor under the contract will usually be distinguished between trademark and all other IP licences, and then grossed up by 18% (as applicable).

Structuring payments (royalties or franchise fees) as management services fees under the franchise agreement may not be recommendable.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees and royalties, to be conducted in local currency?

According to Article 317 (3) of the Russian Civil Code, the use of a foreign currency under financial obligations is allowed on the territory of the Russian Federation within the framework of the relevant laws and regulations. Russian currency control law does not prohibit the use of a foreign currency in international franchising arrangements. Hence, if the contracting parties have lawfully agreed upon the settlement of royalties or franchise fees in a certain foreign currency under the contract, such provision will be valid and enforceable. And, in the event of a breach of the contract, the Russian court will be able to award the appropriate debts, default interests or late payments (monetary relief) in the contracted foreign currency, as the case may be in practice.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Franchise and commercial agency are, by their legal nature, two different contractual arrangements. Specifically, the functions of the franchisee may not be compared with the functions of the commercial agent in the sense of Russian law. Although the franchise agreement may sometimes be a "blended" contract that has the elements of franchise, service, supply and agency relationships within its scope or subject matter, the risk that a franchisee will be treated purely as the franchisor's commercial agent is very low. Usually, agency relations are mixed with distributorship in Russia (but not with franchising).

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly according to some objective test of fairness and reasonableness?

The concepts of "good faith", "fair dealing" and "reasonableness" are the basic principles of Russian civil law. These principles are supported and enforced by the Russian courts in disputes involving civil-law contracts, including in cross-border deals. Franchises, whether set up between national, national and international, or international parties, are not an exception.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The ongoing franchise relationship may be regulated (and affected) by the local laws on intellectual property and information technology, consumer protection and data protection, advertising and promotion, competition and commercial law, labour and employment, real estate and property law, tax and currency control, as well as other Russian laws and regulations (*please see question 1.2 above*).

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Russian law does not determine any special disclosure obligations in relation to a renewal of an existing franchise at the end of the franchise agreement. Disclosure obligations will be subject to contract (*please see questions 1.4 and 1.6 above*).

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

The franchisee has a "right of first refusal" under Russian law. Specifically, if the franchisee has been performing its contractual obligations in a timely and proper manner, it has a pre-emptive right to extend the term of the franchise agreement under the terms agreed between the parties. If the franchisor ignores this overriding right, or refuses to enter into the agreement with the former franchisee for a new period, and concludes within a year a new franchise agreement granting the same rights to the other (third) party, the former franchisee may demand that such rights be transferred in its favour and may also claim damages incurred as a result of the franchisor's refusal to renew the contract, or may claim damages only.

The "right of first refusal" is a legal tool allowing *bona fide* franchisees to be protected from abandonment by franchisors. Usually, franchisees invest considerable time and effort in the development of their business and, therefore, wish to have legitimate guarantees to be able to continue the franchising activities within the contracted territory and scope of rights for as long as they have been acting in good faith and as required by the contract.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

The franchisee that is refused a renewal of its franchise agreement is entitled to damages. Alternatively, the franchisee is entitled to demand the transfer in its favour of rights granted under a new franchise agreement to the other (third) party along with reimbursement of damages (*please see question 15.2 above*).

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

The franchisee may be allowed or prohibited by the franchisor to transfer its franchise to a third party. Permission, if provided by the contract, may be with or without consent of the franchisor. The franchisor, however, may not restrict transfer by the franchisee of ownership interests or shares in the franchisee's business entity, unless the franchisee has sold or pledged its interests/shares to the benefit of the franchisor (*e.g.* as a result of the change of corporate control phase).

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the former franchisee's franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

The "step-in" right is recognised under Russian law and will be enforceable under Russian practice. If the franchise agreement is terminated, the franchisor may "step into the shoes" of the former franchisee and acquire its rights and obligations in due course. In this case, the franchisor will have to execute and register necessary amendments to the relevant contracts with the existent/registered sub-franchisees. Such amendments may refer to the variation of the contract name, change of the grantor and modification of the franchised rights (as applicable). No other formalities must be complied with in this regard.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the country and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

The "power of attorney" for completion of the "franchise migration" that is provided by the contract will not be valid under Russian law and will not be recognised by the Russian courts. In order to acquire the rights and obligations of the former franchisee, the franchisor will have to sign the necessary amendments with the existent/registered sub-franchisees (*please see question 16.2 above*). Such amendments must be technically executed in the format of amendment agreements or deeds of variation to the sub-franchise agreements. In addition, the executed amendment agreements or deeds of variation will have to be registered with Rospatent to become effective. No other formalities shall be complied with in this regard.

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Sergey is a senior lawyer working in the Moscow office of the law firm "Gorodissky & Partners" (Russia). He specialises in various legal issues related to legal protection, ownership, acquisition, exploitation, licensing, franchising, securitisation, litigation and enforcement of IP and IT rights in Russia and the Commonwealth of Independent States (CIS). Sergey deals with various types of IP/IT, including copyrights and related rights, software and databases, patents and designs, trademarks, brands, and domain names. He also deals with know-how and confidential information as well as privacy and data protection.

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Sergey litigates IP/IT rights and combats unlawful/unauthorised use of IP/IT and illegal content on the Internet, unfair competition and false advertising, parallel imports and grey market goods, counterfeits and piracy. He represents the interests of clients in commercial courts and courts of general jurisdiction and with law enforcement agencies on different infringement matters. Sergey participates in extra-judicial as well as judicial dispute resolution actions, civil procedures, and administrative and criminal proceedings.

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GORODISSKY

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