
THE FRANCHISE LAW REVIEW

FOURTH EDITION

EDITOR
MARK ABELL

LAW BUSINESS RESEARCH

This book is dedicated to
JOHN NELSON-JONES,
an exceptional lawyer and mentor,
who passed the wonder and pleasure of
practising law from one generation to another,
with an unsurpassed generosity of spirit.

THE FRANCHISE LAW REVIEW

Fourth Edition

Editor
MARK ABELL

LAW BUSINESS RESEARCH LTD

PUBLISHER
Gideon Robertson

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Felicity Bown, Thomas Lee

SENIOR ACCOUNT MANAGER
Joel Woods

ACCOUNT MANAGERS
Pere Aspinall, Jack Bagnall, Sophie Emberson,
Sian Jones, Laura Lynas

MARKETING AND READERSHIP COORDINATOR
Rebecca Mogridge

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Robbie Kelly

SUBEDITOR
Janina Godowska

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2017 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of January 2017, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above. Enquiries concerning editorial content should be directed to the Publisher – gideon.roberton@lbresearch.com

ISBN 978-1-910813-42-3

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

Chapter 43

RUSSIA

*Sergey Medvedev*¹

I INTRODUCTION

Franchising presents a double advantage. On the receiving side (the franchisee), it is a quick way to start a business under the umbrella of a renowned brand. The emerging business is backed by the solid commercial experience and positive reputation of the prominent company (the brand or franchise owner). On the giving side, the owner (franchisor) extends the brand or franchise's reach to other markets and obtains a new platform for further business expansion, and this is achieved with money being paid to, rather than by, the owner.

Unsurprisingly, international franchisors have already sought to secure franchising investments in the Russian jurisdiction. Global corporations such as Marriott, Hilton, McDonald's, Starbucks, Subway and many others have offered and successfully sold their franchises to local companies (franchisees). Local companies are also catching up and establishing their own franchise businesses in various sectors, including retail, services, restaurants, bars and hotels.

There are several national franchise associations operating in Russia. While membership of a national franchise association is not mandatory, it may be commercially advisable to a certain extent. There is a local non-profit public organisation called the Russian Franchise Association (RFA), established back in 1997, which helps its members to promote franchising activities in Russia. Although the RFA does not have any regulatory power, it provides useful practical advice on doing franchising business on the Russian market. More information about the RFA can be found on its official website, at www.rusfranch.ru.

From the legal standpoint, cross-border transactions are structured differently in the context of franchising. Many companies prefer direct franchising, while others engage master franchisees. In certain cases, franchise grants are mixed with development rights in one and the same contract. In rare instances, joint ventures are created when the franchise relationship involves a Russian element.

1 Sergey Medvedev is a senior lawyer at Gorodissky & Partners.

According to the relevant provision of Russian law,² under a franchise agreement, the rights holder (franchisor) grants the user (franchisee), for consideration and for a definite or indefinite term, the right to use a set of the franchisor's intellectual property (IP) rights, including trademarks and other contracted IP rights, in the franchisee's business, in particular, trade names and trade secrets (know-how). The key element of the franchise agreement is a protected (registered) trademark. In the absence of a registered trademark, the contract may not be treated or interpreted as being a franchise agreement. Other IP rights, including but not limited to, trade names, know-how, copyrights, patents and software, may be added to the scope of the franchise agreement in addition to, but not instead of, the registered trademark.

In Russia, the principal rule of franchising is that the parties to a contract must be commercial entities. Non-commercial companies or governmental agencies may not enter into franchise agreements. Therefore, limited liability companies will normally represent franchisors in regular franchise deals, providing general corporate and tax benefits. Sometimes, joint stock companies are used in complex franchise transactions involving joint ventures.

II MARKET ENTRY

i Restrictions

For the most part, there are no legal restrictions on foreign franchisors in respect of local equity ownership or real estate ownership in Russia. When entering the Russian market by way of granting a master franchise or development rights to a local entity, foreign companies should comply with all relevant national laws and regulations governing conclusion of franchise contracts, performance of obligations and the general civil law principles applicable to business operations.

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

In general, a foreign company is free to offer and sell a franchise or development rights directly or indirectly to a local entity. In other words, the foreign franchisor may enter into a franchise agreement directly with the Russian franchisee to develop the franchised business in Russia, or engage another partner (subfranchisor) who will grant subfranchises to different local entities (subfranchisees) under the effective subfranchise agreements. Indeed, there is no legal requirement to set up a new local entity or own equity in the Russian company as a condition precedent for carrying on franchising activities in Russia.

ii Foreign exchange and tax

Generally, with regard to foreign exchange issues, there are no legal restrictions on the repatriation of franchise fees to an overseas franchisor.

As a general rule, the Russian franchisee is required to open a 'transaction passport' with a competent bank to remit the payment of the franchise fees to a foreign franchisor.

2 Article 1027 (1) of the Russian Civil Code (Part II).

The above rule applies only to the corresponding franchise operation for contracted amounts of US\$50,000 (or more). The bank will issue the document (transaction passport) if the underlying franchise agreement (the original document) is properly translated into Russian, and the granted franchise is registered with the Federal Service for Intellectual Property (Rospatent). Without the transaction passport, franchise fees cannot be sent to an overseas franchisor.

Basically, Russian currency control law does not prohibit the use of a foreign currency in the context of international franchising.

With regard to the issue of taxes, there is no special franchise tax applicable to cross-border franchising.

Usually, all franchise fees payable to the foreign franchisor will be subject to value added tax (VAT) and corporate income tax (CIT), which need to be withheld by the Russian franchisee from the relevant contract price. Importantly, there are certain VAT exemptions and CIT reliefs that should be considered when structuring franchise operations in Russia.

III INTELLECTUAL PROPERTY

i Brand search

Generally, the Rospatent online databases are publicly available to conduct IP searches and to obtain any related information on registered IP rights and published applications. The online databases of the Eurasian Patent Organisation are publicly available to conduct patent searches and obtain relevant information on Eurasian patents and published Eurasian applications. Information on international trademarks registered in Russia is also available in ROMARIN, the World Intellectual Property Organization online database. Information on Russian registered trademarks is available in the TMview online database system of the European Union Intellectual Property Office (formerly the Office for Harmonization in the Internal Market), while information on Russian registered designs is available in the same organisation's DesignView online database system.

In addition, different fee-based search tools are also available. For example, Rospatent provides trademark search and trademark proprietor search services. Different turnaround times are prescribed according to the Rospatent schedule of fees. Official search results may be obtained on an urgent basis, even within one day, but the associated costs are relatively high.

Other IP or franchise-related searches, including for image rights and business processes, may be conducted on the internet.

If there is conflict, it is possible to file oppositions, cancellations or even bring an infringement claim, depending on the situation at issue.

ii Brand protection

Trademarks

Trademark registration will be the very first and key element for every franchise transaction targeted at Russia. A trademark may not be granted for use within the scope of a franchise, unless it is properly protected (registered) in Russia. Therefore, a foreign trademark, or mark-in-use, or pending trademark application cannot be licensed by way of a franchise agreement.

Trademarks may be protected on a national or international basis. National marks will have to be filed and registered with Rospatent. Russia is a signatory to the Madrid Agreement and the Madrid Protocol, therefore, an international trademark registration (designating Russia) will also be protected in Russia.

The duration of the national trademark registration procedure is approximately one year. The examination procedure includes formal and substantive examination. In the course of substantive examination, Rospatent runs absolute and relative grounds tests to allow or refuse trademark registration.

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 permitted.

To be registered, a mark has to be new and distinctive. Distinctiveness may be inherent or acquired. A trademark can acquire distinctive character through intensive and actual use in commerce.

In general, 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. At the same time, the owner must start using the trademark within three years of registration. If the mark is not used during any three-year term following trademark registration, any interested person may apply for cancellation of the trademark protection on the grounds of its non-use.

When the trademark is registered, it is entered into the Russian Trademark Register and will be valid for 10 years. Trademark registrations can be renewed for 10-year periods an unlimited number of times.

Copyright

Most often, franchisees will be granted access to certain business standards, operations manuals and proprietary software. As a result, copyright vested in these works may be included (along with trademarks) in the content of the underlying franchise agreement.

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 must satisfy two fundamental criteria. It must (1) represent a result of creative input, and (2) be fixed in any tangible medium of expression (e.g., paper, CD-ROM).

Generally, the following examples of works of authorship can obtain copyright protection in Russia:

- a* literary works;
- b* dramatic works;
- c* musical works;
- d* choreographic works and pantomimes;
- e* audio-visual works;
- f* sculptural, graphic and design works;
- g* photographic works;
- h* architectural works;
- i* pictorial works;
- j* computer programs; and
- k* databases.

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. However, there is a unique national system of registration available for computer programs and databases. This registration may give an 'irrebuttable' presumption of copyright ownership and protection.

Basically, the standard 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.

Know-how

Many franchise agreements will incorporate know-how licences, as the transfer of proprietary and confidential information is usually regarded as the most critical aspect of every franchise business.

Any piece of confidential information may be protected as know-how. Know-how is not to be registered or deposited; nevertheless, the owner must undertake certain reasonable measures to maintain the confidentiality of the relevant data. If these 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 set up a 'trade secrets regime', as it is described in the law. More specifically, the owner has to properly identify and list the confidential information, limit access to the confidential information by establishing an appropriate procedure for dealings with the same, affix the notice 'trade secret' to the medium in which the confidential information is stored (along with the owner's details) and follow up with other required steps. If one of these steps is ignored or omitted by the owner of the confidential information, the trade secrets regime will not be considered as having been introduced, and, as a result, the know-how protection will not be afforded to the trade secret.

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

iii Enforcement

The IP enforcement system is well developed in Russia. IP rights, whether franchise-related or not, are enforced quite actively and efficiently by their respective owners or their registered exclusive licensees.

Infringement of IP rights may primarily be prosecuted through administrative, civil or criminal proceedings. Furthermore, a special quasi-judicial procedure based on unfair competition is available. Finally, cease-and-desist or warning letters are a mandatory pre-judicial remedy for companies wishing to sue infringers in court.

Administrative proceedings

In accordance with the applicable administrative law, unlawful use of a patent, trademark or copyrighted subject matter entails both an administrative fine, which has to be paid into the state budget, and confiscation of the counterfeit goods for the purpose of destruction.

Administrative proceedings usually begin with a complaint, which the IP owner has to file with the police office or customs authority, so that the latter can organise a raid or take any other necessary action.

Administrative action may take about three to five months to be completed, unless the decision of the first instance court is appealed by the infringer.

Practically, in the context of importation of counterfeit goods into Russia, an administrative procedure proves to be the most effective enforcement option to stop the IP infringement at the border. This measure is also applied when small shops offer for sale and sell fake products on the internal market.

Civil proceedings

In the framework of civil proceedings IP owner (or its registered exclusive licensee) is normally entitled to seek the following legal remedies: (1) injunctive relief (preliminary and permanent injunctions); (2) monetary relief (damages or monetary compensation); (3) seizure and destruction of counterfeit goods and related equipment or materials; and (4) publication of a court order.

Civil proceedings begin with a statement of claims (lawsuit), which is to be filed with the competent court. Russia does not support the discovery system at the pretrial stage, therefore, all pieces of evidence must be collected and secured in advance of the lawsuit. If it is not possible to obtain certain evidence from the infringer before the action, or the latter refuses to disclose the evidence, the plaintiff may discover the evidence through the agency of the court during the civil procedure.

The duration of civil action will vary depending on the IP subject matter involved and specifics of the case at issue. Typically, the decision of the court may be obtained within six to 12 months, unless appealed.

Practically, civil procedure is widely used as enforcement option to tackle parallel imports and grey market goods, including those offered on the internet. This measure is also applied when terminated or former franchisees continue doing business using the franchisor's trademarks, copyrights, know-how and other IP assets after termination of the underlying contractual relationship.

Criminal proceedings

Illegal use of IP rights may also lead to criminal prosecution.

In accordance with the applicable criminal law, unlawful use of a patent, trademark and copyrighted subject matter entails criminal liability only in the event of a substantial amount of damage being caused to the IP owner, or if the IP infringement is repeated.

The typical statutory criminal sanctions are the following: (1) criminal fine; (2) forced labour; (3) correctional works; and (4) imprisonment. In the course of criminal procedure, the IP owner is also entitled to file a civil lawsuit to recover damages.

The total duration of criminal proceedings is usually hard to predict, although the approximate timing is about one to two years, unless the decision of the first instance court is appealed by the infringer.

In practice, criminal procedure is applied against large-scale or gross infringers who are manufacturing and distributing counterfeit goods in large quantities.

Unfair competition action

IP infringement may be a matter of unfair competition, which is prohibited. Unfair acquisition and use of IP rights is not allowed either. Passing off and imitation of trade dress are also treated as unfair behaviour, which may be prosecuted.

The Russian Federal Anti-monopoly Service (FAS) is empowered to consider disputes related to unfair competition through a special quasi-judicial procedure. This type of procedure starts on the basis of a complaint filed by the injured party (e.g., the IP owner or local distributor).

Should the action on unfair competition be eventually successful, the respondent (infringer) would be forced to cease the established illegal activities and pay the administrative fine in favour of the state budget (which may be up to 0.15 per cent of the corresponding infringer's profits).

This procedure usually lasts about six to 10 months, although it can take longer if the binding order of the FAS is appealed in court.

Cease-and-desist letter

Cease-and-desist or warning letters are mandatory in Russia. In other words, it is not possible to sue the infringer in court if a demand letter has not been dispatched in advance of the civil action.

In accordance with the applicable law, the infringer has 30 days to respond to the cease-and-desist letter. Failure to respond, or receipt of a negative reply, provides the IP owner (or its registered exclusive licensee) with a legal standing to sue.

Sending a demand letter to the alleged infringer asking for a voluntary cessation of IP infringement may be the easiest out-of-court enforcement option in many practical situations.

iv Data protection, cybercrime, social media and e-commerce

Data protection

In the context of franchising, if the parties deal with processing of personal data, especially in relation to Russian individuals (data subjects), the applicable data protection law has to be considered.

More specifically, the franchisor or franchisee (as applicable) can be considered as the data operator (data controller) or the data processor (person acting under the instructions of the data operator), or both. If the franchisee outsources data processing to a franchisor, for example, both parties must enter into a data-processing agreement, conditional on the data subject's consent. If the franchisor would like to use the franchisee's clients' data for certain advertising or marketing purposes, the consent of the respective data subjects (addressees) must also be obtained.

In general, the data subject's consent must be specific, informed and conscious. Unless otherwise provided by the law, the data subject's consent can be obtained in any form, including online. In cases where the law requires the data subject's consent to be given in writing (e.g., biometric data), implied or inferred consent will not be regarded as valid. The burden of proof that the data subject's consent has been received remains with the data operator. In addition, a data operator that is processing personal data of Russian individuals must notify the Russian IT regulator (Roskomnadzor). The notification can be submitted by the data operator on paper or electronically.

In the event of cross-border data flow, it is essential to ensure that the rights and interests of data subjects are fully protected in an adequate manner in the corresponding foreign jurisdiction. International data transfer to a country that does not provide a level of adequate protection is only permitted if the written consent of the data subject concerned has been obtained, or the data transfer is made for the performance of a contract to which the data subject is a party.

Importantly, if the franchisor or franchisee (being the data operator) collect, systematise and accumulate personally identifiable information on Russian citizens, that data will need to be stored in data centres or databases located in Russia.

Finally, the data operator must take necessary and sufficient measures, including from the technical, organisational and legal perspectives, to protect personal data that is being processed from unauthorised disclosure, access, theft, etc.

Social media and e-commerce

Generally, under the franchise agreement, the franchisee may be permitted to or prohibited from developing the franchised business on social media or in the digital arena. If the franchisee is permitted by the franchisor to advertise the franchised brand on social media and conduct e-commerce by offering the franchised products online to customers, the relevant national laws regarding telecommunications, information protection, advertising and online trade will apply and must be complied with.

Furthermore, pursuant to the provisions of Russian franchise law, it is possible to create an obligation for the franchisee to offer and sell goods exclusively within its contracted territory. At the same time, the relevant clause in the franchise agreement obliging the franchisee to sell goods solely to the customers located or residing in the contracted territory, shall be null and void.³ Hence, as long as the franchisee restricts its activities to the franchised territory, it is free to sell goods to different customers, especially by way of an online platform, from all over the world.

Finally, any use by the franchisee of the franchise trademark (or similar mark) on the internet or in its domain name after termination or expiration of the franchise agreement may lead to trademark infringement and other sanctions established by the applicable law and the contract. Unless assigned in an amicable (non-judicial) manner, which may be agreed between the parties, the conflicting domain name may be recaptured in the course of civil procedure (litigation) with the competent national court. Uniform Domain-Name Dispute-Resolution Policy (UDRP) proceedings are not effective for .ru, .su and .pф domains, although the Russian courts do recognise and apply the UDRP principles (criteria) when establishing trademark infringement in the course of local domain-name dispute-resolution practice.

IV FRANCHISE LAW

i Legislation

There is no dedicated franchise act in Russia. Franchising activities are specifically regulated by the Russian Civil Code (Chapter 54 of Part II). In addition, the general provisions of the national civil law, especially those that govern the law of contracts and performance of obligations (Part I of the Russian Civil Code) and intellectual property law (Part IV of the Russian Civil Code), may also apply to franchise operations. Finally, the ongoing franchise relationship may also be affected by local laws on competition and commercial law, labour and employment, real estate and property law, tax and currency control, information technology and data protection, advertising and consumer protection, as well as other effective Russian laws and regulations.

3 Article 1033 ((2) of the Russian Civil Code (Part II).

ii Pre-contractual disclosure

Pre-contractual disclosure is not mandatory under Russian law. Nor does Russian law require the franchisor to provide disclosure updates within the term of the franchise agreement. The law only states that the franchisor shall provide technical and commercial documentation, and any other necessary information for the franchisee to be able to develop the franchised business, and to instruct the franchisee and its employees on the aspects associated with franchising activities. However, this does not necessarily mean ‘pre-contractual disclosure’ in the sense understood in international franchise practice.

The foregoing disclosure obligations may be established by the parties on the basis of the doctrine of *culpa in contrahendo* and the principle of good faith at the stage of negotiations pertaining to a prospective franchise transaction.

The format of disclosure is not prescribed by Russian law or published by any governmental agency. Hence, the parties to a contract are free to use and be guided by the documentation normally used in overseas franchising deals.

iii Registration

Every franchise agreement has to be made in writing. In addition, the grant of franchise contemplated by the underlying franchise agreement must be registered with Rospatent. A franchise that is not registered with Rospatent will be invalid.⁴ As a result, the parties will not be able to enforce the contracted rights or obligations against third parties in the event of a non-registered franchise grant. Hence, registration shall not be waived, whether in the context of domestic or cross-border franchising.

Russian law does not set a specific limitation period within which the franchise grant has to be registered with Rospatent. Unless there is an agreement to the contrary, the registration obligation vests with the franchisor, who must prepare and file the appropriate set of documents with Rospatent.

There are various options regarding documents that may be submitted to Rospatent in support of the concluded transaction in addition to the power of attorney authorising the local representative to make the filing. It is, therefore, possible to provide: (1) the original franchise agreement; (2) a notarised excerpt from the same; or (3) the statement of franchise (notification), executed by the parties. Before filing, it is essential to ensure that the document that has been chosen for submission to Rospatent contains all essential elements (mandatory clauses) required by Russian law and dictated by local practice. Importantly, if the parties do not wish to disclose the original contract along with stated financial information or any other sensitive data, the best option would be to make and file an excerpt from the agreement, or present the notification.

In practice, the registration process may take about two to three months in the absence of office actions or Rospatent enquiries.

iv Mandatory clauses

The franchise agreement may contain various terms and conditions depending on the transaction structure and the parties’ negotiations.

⁴ Article 1028 (2) of the Russian Civil Code (Part II).

In general, a contract of this type will usually contain a section on the parties and a statement of their intentions, definitions and interpretation, the franchise or licence grant, term and renewal, franchise fees and payment order, the franchisor's and franchisee's duties, site selection or construction and approval, training and education, inspections and audits, accounting and records, advertising and promotion, protection of franchised assets and confidential information, default and termination, the franchisee's rights and obligations upon termination, franchise transfer and subfranchising, and governing law and dispute resolution, as well as other general clauses.

As regards Russian law and registration, the franchise agreement must address the following essential elements (points):

- a* parties (i.e., corporate names and addresses);
- b* subject matter (i.e., registration numbers of the franchised trademarks and description of the other franchised IP rights (e.g., copyrights, know-how));
- c* franchised products (i.e., goods or services for which the licensed trademark is protected and licensed);
- d* scope of franchised rights (i.e., permitted manners of IP use and distribution of franchised goods or services);
- e* franchisee's duties and covenants (i.e., compliance with standards or manuals, quality compliance, confidentiality obligations, non-compete, site selection and approval, customers' support, etc.);
- f* consideration (i.e., franchise entrance fee, lump sum, royalties, etc.);
- g* type of franchise (i.e., sole versus exclusive versus non-exclusive);
- h* term (i.e., term of protection of franchised IP or certain specific period);
- i* territory (i.e., whole of Russia or certain specific areas);
- j* subfranchising (i.e., permitted or prohibited, how many versus to whom, etc.);
- k* franchise renewal (i.e., franchisee's right of first refusal);
- l* termination (i.e., mutual or unilateral, for cause or convenience, etc.);
- m* post-termination (i.e., franchisee's rights, obligations and liabilities following termination); and
- n* signatures (i.e., names and titles of signees).

v Guarantees and protection

In the context of franchising, a franchisee can resort to different types of guarantees and protection measures to secure its contractual obligations to a franchisor. First of all, the franchisee can obtain insurance coverage from an insurance company for the risks associated with the development of the franchised business. Second, the franchisee may guarantee the performance of its duties through the agency of a third party, including the director general or company owner. In addition, the franchisor can be secured by way of engagement of a bank or other commercial organisation providing an independent guarantee over the transaction. Finally, the parties may negotiate the payment of security deposits or default interests to ensure the payment of franchise fees.

V TAX

There is no specific franchise-related tax in Russia. A foreign franchisor must take into account VAT and CIT on the contracted franchise fees, while the local franchisee, as the franchisor's tax agent, is responsible for withholding the corresponding taxed amounts. In addition, the parties should observe certain local transfer-pricing rules.

i Franchisor tax liabilities

Foreign franchisors must add 18 per cent VAT on to franchise fees payable by Russian franchisees under the franchise agreement.

The licensing of patents, industrial designs, know-how, computer programs, databases and mask works are exempt from VAT, while trademark and copyright licences will be taxed under the underlying franchise agreement.

In addition, franchise fees payable to a foreign franchisor by a Russian franchisee are subject to 20 per cent CIT, unless there is a special double tax treaty in place between Russia and the foreign state where the franchisor resides, as this would provide certain tax reliefs.

ii Franchisee tax liabilities

If the foreign franchisor does not have a permanent establishment or a representative office in Russia, the Russian franchisee acts as a tax agent for the foreign franchisor. Therefore, the Russian franchisee must withhold the corresponding VAT amount from corresponding franchise fees related to trademark and copyright licences set forth by the franchise agreement, and remit that amount to the state budget.

In addition, the Russian franchisee, acting as a tax agent for the foreign franchisor, shall withhold the corresponding CIT amount from the contracted franchise fees and remit this to the state budget, unless there is a special double tax treaty in place between Russia and the foreign state where the franchisor resides, as this would provide certain tax reliefs.

Also, the franchisee will be able to deduct the VAT-able amount as well as the amount of franchise fees when paying its own CIT to the government.

iii Tax-efficient structures

In terms of tax-efficient franchising operations, the following best practices can be recommended.

VAT exemption

There should be separation of the underlying IP licence grants, documentation and pricing under the franchise agreement in relation to VAT-able items (i.e., trademarks, copyright) and non-VAT-able items (i.e., patents, industrial designs, know-how, computer programs, databases, mask works).

Double tax treaty

If the foreign franchisor is established in and operates under the laws of a foreign state that has a special and effective double tax treaty with Russia, a zero or reduced CIT rate may be applied; to enjoy that tax relief, the foreign franchisor must provide the Russian franchisee with valid and certified documentary proof of its tax residency in the relevant foreign state.

Special tax clause

It is possible to include a special tax clause in the franchise agreement related to the calculation of all withholding taxes without affecting the amounts (franchise fees) payable to the foreign franchisor.

Transfer pricing

The amount of contracted franchise fees should be in compliance with the corresponding market price level to avoid additional taxes and penalties.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

There is a specific provision in Russian law to the effect that contracting parties, while exercising their rights and performing their obligations, should be acting in good faith. There is also a general civil law principle that actions of persons carried out with the sole purpose of causing damage to other persons are prohibited. Hence, abuse of rights and unfair behaviour are not allowed, while the duty of good faith shall always be guaranteed, especially in terms of making transactions. The concepts of good faith and fair dealing are supported and enforced by the Russian courts in contractual disputes, including franchise-related ones.

ii Agency distributor model

Franchise and commercial agency are two different contractual arrangements. Specifically, the functions of the franchisor or franchisee may not be compared with the functions of the principal or agent according to Russian law.

Even though the franchise agreement may sometimes be a 'blended' contract, with many elements incorporated in it, the risk that a franchisor will be treated purely as a principal and the franchisee treated purely as the franchisor's agent is very low.

Usually, agency relations are mixed with distribution, but not with franchising, in Russia. And, importantly, in Russian civil law there is no such contractual model as the distribution contract.

iii Employment law

The franchisor and the franchisee are separate legal or commercial entities operating under the concluded franchise agreement. Therefore, they have their own labour and employment obligations in relation to their own employees, but not in relation to each other. The terms and conditions of the franchise agreement are primarily governed by civil law (i.e., the Russian Civil Code), while the labour and employment relations of entities doing business 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 applicable labour law also stipulates that the conclusion of civil law agreements, which de facto govern the relationship between the employer and the employee, are not allowed.⁵

5 Article 15 of the Russian Labour Code.

Therefore, there is no risk or likelihood that the franchisee (or even the employees of the franchisee) will be treated as the employees of the franchisor in Russia.

iv Consumer protection

In Russia, franchisees cannot be treated as consumers under any circumstances. The Russian Law on Protection of Consumers' Rights covers the protection of rights of individual consumers acting as physical persons (not business entities). In other words, the applicable consumer protection law governs business-to-consumer relations, while the franchise relationship may only be created in the business-to-business sphere.

v Competition law

Generally, the applicable law, or competition law, prevents monopolistic (anticompetitive) activities, 'cartels' and abuse of dominance. The law also prohibits unfair competition. In this regard, dissemination of false information or unfair advertising that may damage an operating business entity is not allowed. Passing off and unauthorised IP acquisition and use may be treated as unfair behaviour and, therefore, sanctioned. Importantly, competition law allows 'vertical' contracts, including franchise agreements, whether made between foreign or domestic companies.

According to Russian law, a franchise agreement may impose different obligations and covenants on the franchisee, particularly those listed in Section VI, *infra*. Theoretically, these covenants, to the extent they are incorporated in the franchise agreement, may be declared invalid by the FAS (or other interested person) if they are found to be contradictory to anti-monopoly laws, subject to the relevant market conditions and economic status of the parties. In practice, the standard contractual restrictions provided in franchise agreements and made in line with relevant provisions of Russian law, including non-compete covenants, are acceptable from the antitrust standpoint.

Importantly, a franchise granted to the franchisee may be sole, exclusive or non-exclusive. If the granted franchise is sole, the franchisor loses its right to use the franchised set of IP rights in the franchised territory on its own and loses the right to offer and sell the same franchises to third parties in the franchised territory. If the granted franchise is exclusive, the franchisor may reserve the right to use the franchised set of IP rights in the franchised territory on its own, but nonetheless loses the right to offer and sell the same franchise to third parties in the franchised territory. If the franchise is granted on a non-exclusive basis, the franchisor is free to franchise the already franchised set of IP rights in the franchised territory to others.

There is no maximum permitted term within which a franchise agreement may be effective. The franchise agreement may be concluded within a definite or indefinite term. If the franchise agreement is made for a definite term, 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 set of IP rights that has been licensed under the franchise agreement. If the term of the franchise agreement is not defined by contract, the franchise will be regarded as granted and effective for five consecutive years (starting from the corresponding registration date).

As follows from Russian law, the franchisee may be obliged by contract to sell the franchised goods under prices fixed by the franchisor. However, fixing of prices, including minimum resale prices, may fall under the supervision of the FAS. The agency may, within the scope of its competence, tackle any anticompetitive practices if they entail or may entail the fixing or support of prices (tariffs). Therefore, if the Russian Federal Anti-monopoly Service

finds the contractual provision on pricing or minimum resale price to be in contravention of anti-monopoly laws, subject to the relevant market conditions and economic status of the parties, the clause may be deemed invalid by the agency.

The franchised territory (region, city, street, address, etc.) may or may not be specified in the contract. 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 certain boundaries or territory, the franchise will be valid in the contracted territory.

vi Restrictive covenants

The franchise agreement may contain different restrictive covenants imposed on the franchisee as allowed under the Russian law.⁶ The scope of the same will usually depend on the parties' negotiations and arrangements.

More specifically, the franchisor may elect for the following covenants to be incorporated into the contract: (1) the franchisee's covenant not to compete with the franchisor in the franchised territory in relation to the franchised business and franchised set of IP rights; (2) the franchisee's refusal to accept analogous rights under franchise agreements from competitors (potential competitors) of the franchisor; (3) the franchisee's covenant to distribute and sell the manufactured or purchased goods, perform works or provide services by using the franchised rights and applying the prices fixed by the franchisor; (4) the franchisee's covenant to refrain from distribution of analogous goods, performing analogous works, and providing analogous services using the trademarks or trade names of other franchisors; (5) the franchisee's covenant to sell goods, perform works or provide services exclusively within the boundaries of certain territory; and (6) the franchisee's covenant to obtain approval from the franchisor for the location (as well as the exterior or interior design) of the commercial premises used for implementation of the franchised rights under the contract.

The above restrictive covenants are allowed under relevant provisions of Russian law and may be enforced if not complied with, especially during the term of the franchise agreement. The Russian court system has already tested a few cases in which non-compete covenants were prosecuted in favour of the cases' respective claimants (franchisors).

vii Termination

The franchisor and franchisee are free to use the wording of Article 1037 of the Russian Civil Code to create a valid termination clause in the franchise agreement.

More specifically, according to Russian law, any party may terminate a contract at any time if the franchise agreement has been concluded for an indefinite term. Six months' prior written notice is required in this case, unless the contract indicates a longer term for the advance termination notice. 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 terminate 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 certain 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 has been set out

6 Article 1033 (1) of the Russian Civil Code (Part II).

in the contract. The franchisor may also repudiate the franchise agreement if the franchisee does not follow the franchisor's instructions and guidance aimed at ensuring compliance with the contractual provisions related to the terms and conditions of use of the franchised set of IP rights. Finally, the franchisor may cancel the franchise agreement if the franchisee fails to settle the franchise fees on the terms set out by the contract.

Termination by the franchisor is 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.

If the franchisor's right to the franchised trademark or franchised trade name (included in the franchised set of IP rights) is lost for any reason, the franchise agreement will be terminated, unless any similar (effective) IP asset is granted (substituted) by the franchisor.

If the franchisor or the franchisee becomes insolvent (bankrupt), the franchise agreement shall be dissolved.

Termination of the franchise agreement is subject to registration with Rospatent. In the absence of registration, the termination will not be effective.

As to post-term restrictions, especially the non-compete covenant, these may be deemed enforceable, provided it is clearly stated in the contract that they survive the termination. Moreover, the franchisee will be regarded as infringer if he or she continues using the franchised set of IP rights following the termination of the franchise agreement.

Although in practice it might be very difficult to take over the franchisee's business, this issue is negotiable and subject to contract. Sale and purchase arrangements, preliminary agreements, call options and conditional instruments are available under Russian law and may be implemented by the parties.

The franchisee's entity may be owned by the franchisor, and the latter may corporately restrict any transfer of the ownership interest in the franchisee's entity to a third party.

The sale of stakes in the franchisee can only be limited if the franchisor also owns some or a majority of the same in the franchisee's company.

In the context of commercial property, there are no restrictions on foreign companies holding an ownership or lease interest in Russian real estate. Therefore, the question of taking local leases or premises shall be discussed between the parties. Relevant amendments to lease contracts, or the associated assignments, will have to be registered with the Russian State Register of Real Estate Rights and Transactions. Finally, the parties can make the lease agreement conditional on the franchise agreement, hence allowing the lease agreement to be terminated as soon as the franchise agreement is terminated.

viii Anti-corruption and anti-terrorism regulation

Russia is a party to a number of international treaties governing anti-corruption, including the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (dated 1997). There are a few national laws prohibiting terrorism, corruption, money laundering and fraud, namely the Russian Law on Terrorism Resistance (dated 2006), the Russian Law on Combating Corruption (dated 2008), and the Russian Law on Combating the Legalisation of Proceeds of Crime and Terrorist Financing (dated 2001), as well as other local acts and subordinated regulations in this field. The Russian Code on Administrative Offences and the Russian Criminal Code set out strict administrative and criminal liabilities for failure to comply with anti-bribery and anti-money laundering rules, and provide various sanctions for corresponding violations, for entities and individuals.

Therefore, potentially susceptible businesses, including those of franchisors and franchisees, are obliged to abide by these laws, and the national law enforcement agencies are vigilant in monitoring compliance.

ix Dispute resolution

Generally, franchise-related claims, certain unfair competition conflicts and IP infringement disputes that involve the Russian market, or are targeted at Russia, tend to be litigated through local courts. The system of commercial courts has basically four instances: (1) the first instance courts, (2) the appellate courts, (3) the cassation courts, (4) the Russian Supreme Court. There is also a special Russian Intellectual Property Court operating as the court of first instance or court of cassation and empowered to hear IP-related cases. Franchising disputes may fall under the jurisdiction of the Russian IP Court at the cassation stage (third level).

Compared with other jurisdictions, Russia may be a jurisdiction to consider in terms of timing, costs, remedies and enforcement proceedings associated with dispute resolution. For example, it may take about six months for an IP infringement claim or contractual breach matter to reach the stage of the decision of the first instance court, and then four months to accomplish the enforcement procedure, if it has not been appealed. Remedies can include preliminary and permanent injunctive reliefs, as well as monetary reliefs (e.g., statutory damages). To obtain statutory damages it is sufficient to prove the fact of the IP infringement having occurred. To obtain lost profits it is necessary to demonstrate: (1) the amount of the damages arising, (2) the method of calculation of the asserted damages, and (3) the nexus between the damages claimed and the illegal activities of the respondent. Cases may be settled at any stage of the civil procedure. Settlement agreement will be approved by the competent court if the agreed provisions do not affect the rights and legitimate interests of third parties. Attorneys' fees may be capped by the clients' respective lawyers and are recoverable from the losing party. If the case is being settled, the parties are free to allocate the attorneys' fees in whatever proportions they want. The general limitation period for the case to be brought to trial is three years, and the same period applies for the commencement of the enforcement procedure, when the court decision becomes effective.

There has been rather a large number of noteworthy franchising disputes resolved in front of national courts. A few of them reached the Supreme Court, while many were concluded in the Russian IP Court. These conflicts concerned different issues, including the trademark grant and infringement, contract validity and termination, franchisees' non-compete obligations and non-performance of their financial obligations. In the majority of cases, franchisors prevailed in these civil actions.

Instead of resorting to litigation in local courts, the franchisee and franchisor can contractually agree on arbitration. Arbitration may be conducted in any jurisdiction and in any forum chosen by the parties. If there is no arbitration clause in the contract, the contract may not be submitted to arbitration. Russia is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (dated 1958) (the New York Convention). Hence, an arbitral award received from another jurisdiction that is a signatory to the New York Convention may be enforceable in Russia.

The local courts will also enforce orders granted by foreign courts. Indeed, a court judgment issued by another jurisdiction may be enforceable in Russia, provided that recognition and enforcement of the foreign court judgment is stipulated by the relevant

international treaty, and 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.

The Russian Civil (Commercial) Procedure Code provides certain formal or mandatory requirements for recognition and enforcement of foreign judgments. These include, *inter alia*, the following significant aspects: (1) effectiveness of the court judgment under the law of the jurisdiction in the territory on which it has been issued; (2) compliance with the statutory three-year term for filing a motion for recognition and enforcement of the foreign court judgment; and (3) consistency of the foreign court judgment with Russian public policy. If these requirements are not met, a Russian court may refuse to recognise and enforce a foreign judgment.

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

Mediation is also available as an alternative method of dispute resolution. Franchising conflicts are rarely mediated in Russia.

VII CURRENT DEVELOPMENTS

The business of franchising is growing internationally and apparently will continue to develop, from both an economic and a legal perspective. There are a lot of attractive segments and unexplored areas of the global market where the franchising model will fit perfectly and integrate well, and the Russian market does not represent an exception to this pattern.

Indeed, the Russian legal system has already adapted to the global franchise practice and currently provides great, legitimate investment opportunities for market participants and their brands, technologies, trade secrets, systems, reputation and other assets. There have already been several packages of civil law amendments recently submitted, discussed and implemented by the government to 'close the gaps' in certain areas of national contract law, including franchise law. With these amendments in force, Russia is now welcoming new franchise business entrants to the country.

Appendix 1

ABOUT THE AUTHORS

SERGEY MEDVEDEV

Gorodissky & Partners

Sergey Medvedev, PhD, LLM 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, litigation and enforcement of IP and IT rights in Russia and CIS.

Sergey deals with various types of IP and IT matters, 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.

Sergey provides legal support to clients in connection with various transactions related to disposal and conveyance of IP and IT assets. He is regularly in charge of developing, reviewing, negotiating and perfecting assignment deeds, licence agreements, franchise contracts, security agreements and other contractual arrangements. Sergey is also involved in heavyweight M&A, joint venture and investment projects, master development and franchise transactions, IP and IT legal due diligence and IP and IT transfer processes.

Sergey litigates IP and IT rights and combats unlawful or unauthorised use of IP and IT as well as illegal content on the internet, unfair competition and false advertising. He also tackles parallel imports and grey market goods, and fights against counterfeit goods and piracy. He represents the interests of clients in the courts and before law enforcement agencies on a variety of IP and IT infringement matters. Sergey participates in extra-judicial and judicial dispute resolution actions, civil and litigation procedures, and administrative and criminal proceedings.

Sergey frequently delivers speeches at national and international seminars and conferences. He is the author of a number of articles and works, including on franchising, published by the leading Russian and international publishing houses.

He is a registered member of the Licensing Executives Society International and official attendee of the International Franchise Association. Sergey is also a registered trademark, design and software attorney in Russia.

GORODISSKY & PARTNERS

B. Spasskaya Str., 25, Building 3

Moscow 129090

Russia

Tel: +7 495 937 6116

Fax: +7 495 937 6104

medvedevs@gorodissky.ru

www.gorodissky.com