

# Franchising in Russian Federation: overview

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A Q&A guide to franchising in the Russian Federation.

The Q&A provides an overview of the main practical issues concerning local and international franchising, including: current market activity; franchising regulatory framework; contractual issues relating to franchising agreements (analysing pre-contract disclosure requirements, formalities, parties' rights and obligations, fees and payments, term of agreement and renewal, termination and choice of law and jurisdiction); Operations Manual; liability issues; intellectual property; real estate; competition law; employment issues; dispute resolution; exchange control and withholding; and proposals for reform.

To compare answers across multiple jurisdictions, visit the [Franchising: Country Q&A tool](#).

This Q&A is part of the global guide to franchising law. For a full list of jurisdictional Q&As visit [www.practicallaw.com/franchising-guide](http://www.practicallaw.com/franchising-guide).

## Market

1. What have been the main developments in the franchising market over the past 12 months?

Franchising has become more popular during the current Russian economic and Western-Russian political crisis. Demand for franchising is increasing, and the business climate is improving. In the last year the franchising market in Russia has grown by approximately 4.6%. At the same time the number of fast-food franchising chains (one-quarter of which belongs to overseas franchisors), has increased by 9%. Each of the biggest overseas franchisors such as Burger King, KFC, Subway, McDonald's opens every year 70-100 new restaurants. Currently, fast-food, street food and online food services are considered the most competitive franchise sectors. In particular, online food services has grown in 2016 by 5.7%.

Prior to the crisis, many well-known brands had not considered developing their franchise strategy in Russia, but preferred to open their own sales points. The crisis has caused a change of strategy. The reason for this may be that a franchise business enables the franchisor to conduct business activities in Russia without establishing a Russian subsidiary or other presence. Such a business structure requires less investment, and therefore fewer risks, than a structure which is based on a substantial investment made by the investor itself. Conversely, it provides less control over the activities of the Russian business partner.

2. What are the most commonly used methods of local and international franchising?

### **Local franchising**

In Russia, all common methods of franchising (direct franchising, multi-unit franchises, joint ventures, development agreements) are used. Franchisors rarely take shares in the franchisee, as the franchisee is usually expected to run the business on its own and control over the franchisee is exercised based on the provisions of the franchise agreement.

Multi-unit franchise agreements are favoured over master franchise agreements if the parties wish to avoid registration of multiple sub-franchise agreements, and the franchisor is ready to accept less control over the opening of the franchise units. As a result of the requirement to register sub-franchise agreements, master franchise agreements allow better control over the opening of franchise units.

In the past, development agreements were used for business-related provisions that were not made part of the franchise agreement in order to facilitate the registration of the franchise agreement. However, there is now no reason to use development agreements, as since 2014 only the grant of a licence to use trade marks is subject to registration, rather than the franchise agreement as a whole.

### **International franchising**

International franchisors usually wish to conduct business in Russia using the franchise concepts that they have developed for their worldwide business. The adaptation of these concepts is usually not difficult, as Russian conflict of laws permit the choice of the franchisor's national law as the law governing the franchise agreement (*see Question 24*).

Regarding the methods used for franchising, in principle there is no difference between international and local franchising.

3. Are there any specific reasons for an overseas franchisor to use a separate entity for entering into a franchise agreement with a franchisee in your jurisdiction?

The establishment of a separate franchising vehicle may protect the owner of the business against the liability of the franchisor arising from the franchise business, in particular against the franchisor's liability towards the franchisee's customers (*see Question 29*).

## Regulation of franchising

### 4. What is the legal definition of franchising and/or a franchise?

Under the Civil Code of the Russian Federation (Civil Code), under a commercial contract (the franchise agreement), the rightholder (the franchisor) grants the user (the franchisee), for consideration and for a definite or indefinite term, the right to use a complex of intellectual property rights owned by the franchisor in the franchisee's business, including trademarks (mandatory) and other rights, such as trade names and trade secrets (know-how).

An overseas franchisor should take into account the following matters when choosing the affiliate that will enter into the franchise agreement with a Russian franchisee:

- Taxation (in particular, any applicable double taxation treaties between the affiliate's country and Russia).
- Key element of any franchise agreement is the franchisor's granting to the franchisee of a licence to use a trade mark. The licence is subject to mandatory registration and will only be registered with the Russian Federal Service for Intellectual Property, called Rospatent (*see Question 6*) if both:
  - the respective trade mark is registered in Russia with Rospatent or with the World Intellectual Property Organization; or
  - the whole chain of licences from the owner of the Russia-related trade mark to the franchisor is registered with Rospatent.

### 5. What are the laws regulating franchising?

Franchising is regulated in Chapter 54 of the Civil Code, which is supplemented by section VII of the Rights on the Results of Intellectual Activity and Means of their Individualization. Although Russian law permits the parties to an international franchise agreement to choose another national law as the law governing the franchise agreement, some provisions of the Civil Code are considered mandatory by the Russian courts (for example, the requirement to register the grant of the licence to use trade marks with Rospatent (*see Question 13*) and the franchisor's liability towards the franchisee's customers for defective goods and services (*see Question 29*).

The following mandatory Russian laws may also affect the ongoing relationship between a franchisor and a franchisee:

- Consumer protection laws which protect the rights of the franchisee's customers (if they are consumers), but not the rights of the franchisee, as franchisees can only be legal entities or individual entrepreneurs (*see Question 9*).
- Advertising laws.
- Currency control provisions (*see Question 40*).
- Regulatory requirements (for example, laws on certification and licensing).
- Competition laws.
- Tax and customs laws.

6. What is the regulatory authority responsible for enforcing franchising laws and requirements in your jurisdiction?

The Russian Federal Service for Intellectual Property, Rospatent, is the federal executive authority that has responsibility for controlling and supervising the legal protection and exploitation of intellectual property rights, including patents and trade marks. There is no special franchising regulatory authority.

7. Must the franchisor be registered with a professional or regulatory body before setting up a franchise system?

Under Russian law, the franchisor is not required to register with a professional or regulatory body, or to pilot one or more outlets before setting up a franchise system.

However, as the grant of a right to use trade marks must form part of the franchise agreement, the franchisor's right to those trade marks must be registered with Rospatent (*see Question 13*). If the franchisor's trade marks are not registered with Rospatent, the franchisee cannot be granted any right to use those trade marks and a mandatory prerequisite for a franchise agreement cannot be fulfilled.

8. Is there a code of ethics or other means of promoting ethical franchising in your jurisdiction?

No code of ethics or other means of promoting ethical franchising have been adopted. The Russian Federation is not member of the European Franchise Federation, which has adopted the European Code of Ethics for Franchising (and its national extensions and interpretations).

9. Do franchisees benefit from any laws designed to protect consumers or small businesses?

Franchisees do not benefit from consumer protection laws as franchisees can only be legal entities or individual entrepreneurs which are not consumers. However, there are laws which are aimed at protecting small and medium-sized businesses. In particular, small businesses can apply to be taxed under a simplified tax system under which, instead of profit tax, VAT and property tax, (save for certain exceptions) they pay either:

- 6% tax of their total income.
- 15% tax of their income minus expenses
- Lower tax rate can be established by regions of the Russian Federation for certain types of businesses).

10. Are there any other requirements which must be met before a business can sell a franchise?

There are no further requirements which must be met before a business can sell a franchise.

## Franchise agreement

### Pre-contract disclosure requirements

11. Is the franchisor subject to any general or formal pre-contract disclosure requirements?

Russian law does not provide for express pre-contractual disclosure obligations as do other jurisdictions. However, a franchisor should be aware of certain new provisions of the Civil Code concerning contract negotiations, which in the future may serve the Russian courts as a basis for the development of a concrete and detailed system of pre-contractual disclosure obligations for franchise agreements.

Under the new provisions which were adopted in 2015, the parties to negotiations to enter into an agreement must act faithfully from the start of the negotiations until their end. A party is recognised as not acting faithfully if either:

- It provided the other party with incomplete or untrue information.
- It is silent regarding circumstances which, with regard to the character of the agreement, should be brought to the attention of the other party.

The party that did not conduct the negotiations faithfully is obliged to reimburse the other party for any damages suffered. These damages include the costs that the other party incurred in connection with conducting the negotiations, and the loss of the possibility of entering into the agreement.

However, under the new provisions a party that entered into an agreement due to a lack of complete and true information provided during the negotiations does not have the right to contest the agreement. A right to contest the agreement is only granted to a party that entered into an agreement due to an error which was so substantial that it, reasonably and objectively assessing the situation, would not have entered into the agreement if it had known the actual situation. The law mentions, as examples, errors concerning the nature of the agreement, the item of the agreement or substantial characteristics of the agreement or its contractual party. In the author's view, the right to contest the agreement may help in extraordinary cases, but not in a situation in which information is just incomplete or partially incorrect.

The new provisions expressly permit the parties to enter into an agreement which determines the rights and obligations of the parties during negotiations, and substantiates the requirements to faithfully negotiate. However, that agreement cannot reduce the liability for not acting faithfully during negotiations.

To create more certainty regarding their rights and obligations, parties that intend to negotiate a franchise agreement should enter into an agreement which creates a reliable framework for the negotiations, and in particular, sets the limits for the future franchisor's obligations to provide information to the future franchisee.

12. Must the franchisor disclose fairly and in good faith all facts material to the prospective franchisee's decision to enter into the arrangement, or must the prospective franchisee rely on its own due diligence?

The franchisor must disclose, during negotiations, information which, with regard to the character of the franchise agreement, should be brought to the attention of the franchisee, and must provide complete and true information

(see *Question 11*). However, as it is doubtful that this obligation will be interpreted by the Russian courts as an obligation to provide comprehensive information on the franchise, the prospective franchisee must rely on its own due diligence.

## Formalities

13. What are the formal contractual requirements to create a valid and binding franchise agreement?

A franchise agreement is a special type of agreement provided for in section IV (Special Types of Agreements) of Part II of the Civil Code.

Franchise agreements must be entered into in writing, or they are invalid.

Both the franchisor's rights to the trade marks and the licence to use the trade marks that is given to the franchisee under the franchise agreement, must be registered with Rospatent (see *Questions 6, 7 and 31*). If the registration is missing, no trade marks are licensed to the franchisee. For the consequences to the franchise agreement, see *Question 31*.

The registration of the licence to use the trade marks under the franchise agreement, can be done by filing with Rospatent:

either the franchise agreement itself or

a petition for registration of the licence to use the trade marks signed by one party along with a bilingual notification of such license signed by both parties or an extract from such license certified by a Russian notary or

a petition for registration of the license to use the trademarks signed by both parties.

If the agreement itself will be handed to Rospatent, the language of the agreement must be Russian, or bilingual with one language being Russian, or the agreement must be accompanied by a Russian translation, since Rospatent will only rely on a Russian language text.

See *Question 40* on Russian currency control requirements for payments made under a franchise agreement.

## Parties' rights and obligations

14. Is there a general obligation to behave fairly, reasonably or in good faith to the other party during the term of the franchise agreement?

### **Obligations of the franchisee**

The Civil Code expressly provides that during the term of the franchise agreement, the franchisee must:

- Use, in the course of the activities under the franchise agreement, the franchisor's trade name, trade mark, service mark or other means of identifying the franchisor within the limits provided by the franchise agreement.
- Ensure that the quality of the goods produced by it, and the works and services conducted by it under the franchise agreement are analogous to the goods, works and services sold by the franchisor.
- Observe the instructions and directions of the franchisor that are intended to effect compliance with the character, manner and conditions of the use of the franchise within the franchisor's system, including directions concerning the inside and outside design of the commercial premises used by the franchisee when exercising the rights provided to him under the franchise agreement.
- Render, in relation to the customers, all additional services which they would expect if they purchased goods, works or services directly from the franchisor.
- Not disclose the franchisor's production secrets (know-how) and other confidential commercial information received from the franchisor.
- Provide the agreed quantity of sub-concessions if such an obligation is provided in the franchise agreement.
- Inform customers, in the manner most apparent to them, of the fact that it uses a trade name, trade mark, service mark or other means of identity on the basis of a franchise agreement.

Except for the provision concerning the quantity of sub-concessions, it is not expressly stated whether these obligations can be overridden by express provisions contained in the franchise agreement.

Based on the resolution of the Plenum of the Supreme Arbitrazh Court of the Russian Federation dated 14 March 2014 "On the Freedom of Contract and its Limitations", the author believes that the franchise agreement can substantiate the above obligations, but cannot fully diminish them, as this would result in a gross breach of the balance of the interests of the franchisor and franchisee.

As a result of the above resolution, a provision of the Civil Code must be considered disposable (and therefore not mandatory) unless either:

- It contains an express prohibition on clauses that deviate from the relevant legal provisions.
- Its mandatory character is necessary in order to:
  - protect significant legal interests (for example, the interests of the weaker party to a contract, third persons, public interests, and so on);
  - prevent gross breaches of the balance of the interests of the parties; or
  - comply with the essence of the legislative ruling of the relevant type of contract.

In addition to the franchisee's obligations above, the Civil Code establishes the following general rules concerning fair dealing:

- The parties to civil law relations must behave in good faith regarding the establishment, exercise and protection of civil law rights and the performance of obligations.
- The following actions are prohibited:
  - the exercise of rights in order to damage somebody;
  - actions in circumvention of the law which have unlawful aims;
  - the intentional unfaithful exercise of civil law rights.
- The faithfulness and reasonableness of the parties in civil law relations is expected.

However, there is currently no reliable legal precedent on the interpretation of these legal rules for franchise agreements.

### **Obligations of the franchisor**

Under the Civil Code, the franchisor must provide to the franchisee:

- The technical and commercial documentation required.
- All the information necessary for the franchisee to use the rights granted to him under the franchise agreement
- Instructions necessary for the franchisee, and its employees, to use the rights granted under the franchise agreement (including responding to questions concerning the use of those rights).

In the author's view, under the above resolution of the Supreme Arbitrazh Court of the Russian Federation, the franchise agreement can substantiate the above obligations, but cannot fully diminish them, as these obligations are the essence of the franchise agreement and constitute the main reason why the franchisee has signed the agreement.

The Civil Code also contains the following obligations of the franchisor, from which it expressly permits deviations:

- To arrange for the state registration of the grant of the right to use, within the commercial activity of the franchisee, the complex of exclusive rights belonging to the franchisor under the franchise agreement.
- To provide permanent technical and consultancy assistance, including assistance in training and upgrading the qualification of employees, to the franchisee.
- To control the quality of the goods, works or services sold by the franchisee under the franchise agreement.

The general obligations concerning fair dealing mentioned above also apply to franchisors.

In general, an overseas franchisor or its officers and directors cannot be held liable for failures of local sub-franchisors regarding the above obligations. However, the franchisor remains liable towards the franchisee's customers for damages arising from defective goods, works or services sold under the franchise agreement (*see Question 29*).



15. Does local law require that particular provisions must be expressly included in a franchise agreement?

Russian law requires that the franchisor grants to the franchisee the right to use not only a trade mark, but also other intellectual property rights, such as know-how, copyright or a trade name. The franchise agreement must provide for a remuneration to be paid by the franchisee to the franchisor. For more information, see *Question 4*.

16. Are exclusion and entire agreement clauses enforceable in your jurisdiction? If so, are they effective to protect the franchisor?

In general, exclusion and entire agreement clauses are enforceable in Russia. However, these clauses will not protect the franchisor against liability in the following cases:

- The liability of the franchisor towards the franchisee's customers for damages arising from defective goods, works or services (*see Question 29*) cannot be excluded or limited.
- The liability for not conducting pre-contractual negotiations faithfully (*see Question 11*).
- The liability for warranties that the franchisor has granted before entering into the franchise agreement.

Exclusion and entire agreement clauses in local franchise agreements will not protect an overseas franchisor that is not a party to the local franchise agreement against liability towards the local franchisee or the customers of the local franchisee, as the local franchise agreement only has effect between its parties (that is, the local franchisor and the local franchisee). In particular, exclusion and entire agreement clauses will not protect against the liabilities mentioned above.

17. Can the franchisor impose product tying or other purchasing restrictions and non-compete obligations on the franchisee during the term of the agreement?

#### **Restrictions on purchasing and product tying**

Under Russian law, purchasing restrictions are not prohibited. It is expressly provided that franchise agreements can include an obligation on the franchisee not to sell the products of a competitor of the franchisor.

#### **Non-compete obligations and transfer restrictions**

The following lawful non-compete obligations of the franchisee are expressly allowed by law:

- The establishment of prices by the franchisor for the sale or resale of the goods, works or services.
- The obligation not to receive, under franchise agreements, analogous rights from the franchisor's competitors or potential competitors.
- The obligation to sell goods, works or services exclusively within the agreed territory.
- The obligation to agree with the franchisor the location of the commercial premises, as well as their outside and inside design.

It is not permitted to oblige the franchisee to sell goods, works or services exclusively to customers that have their place of business, or place of residence, at a location determined in the franchise agreement.

In general, obligations that are recognised as an abuse of a market dominating position are prohibited.

The franchise agreement can provide that any transfer of the franchisee's business requires the prior consent of the franchisor. However, the lack of consent will not have any impact on the validity of the sale of the assets (the assignment of the intellectual property rights granted under the franchise agreement excepted) which belong to the franchisee's business.

The sale of shares in the franchisee can only be restricted if the franchisor is also a holder of shares in the franchisee.

## **Fees and payments**

18. What fees are usually payable by the franchisee? Are there any restrictions on the parties' freedom to set the fees and payments, or any other payment requirements?

In principle, the parties to a franchise agreement are free to determine the form and amount of the fee payable under the franchise. The fee can consist of:

- A one-time fixed fee.
- Periodic payments (royalties).
- A percentage of the revenues or profit made by the franchisee.

However, in determining the fee payable by the franchisee taxation should be taken into consideration. In particular, if the franchisor and the franchisee are related parties, the fee may be subject to transfer pricing control.

Under Russian law, the franchisee must pay interest on overdue payments at the key rate of the Central Bank of the Russian Federation. The key rate is the interest rate for basic operations of the Central Bank of the Russian Federation to regulate the liquidity of the bank sector, which is currently 8.25% per annum.

The franchise agreement can provide for a different interest rate. However, if the amount of interest to be paid by the franchisee is obviously unreasonable in relation to the consequences of the payment delay, a court, on application by the franchisee, can reduce the interest payable under the agreement (although it can only reduce the interest to no less than the amount payable on the basis of the relevant key rate of the Central Bank of the Russian Federation).

### Term of agreement and renewal

19. Are parties free to agree on the term of the franchise agreement? What is the typical term of a franchise agreement in your jurisdiction?

Franchise agreements can be entered into for a specific or an indefinite term. A customary term for a franchise agreement is five years, although the parties are free to establish any other term. If the franchise agreement is entered into for an indefinite term, each party can terminate the franchise agreement by giving six months' prior notice to the other party, unless a longer notice period is provided in the franchise agreement.

In any event, the franchise agreement terminates if:

- The term of the franchisor's right to the trade mark, service mark or trade name, which falls into the complex of intellectual property rights that the franchisee has been granted a right to use under the franchise agreement, ends, and that right is not replaced by an analogous new right.
- The franchisor or franchisee is declared bankrupt.

20. What rights of renewal are usually included in the franchise agreement? Are fees paid on renewal?

### Commercial practice

Franchise agreements under Russian law often do not provide for a contractual renewal right, as a renewal right is provided by the provisions of the Civil Code which are likely to be considered mandatory (*see below, Local law*).

International franchisors usually wish to apply their worldwide used standards when agreeing renewal rights. In many franchise agreements, no renewal rights are granted. In others, the franchisee can exercise a renewal option up to a certain date prior to the expiry of the franchise agreement, or the franchise agreement will be renewed automatically unless one of the parties notifies the other party that it does not wish to renew. Fees for the renewal can be agreed on in the franchise agreement, although this is not typical.

### Local law

Under the Civil Code, a franchisee that has properly performed its obligations under the franchise agreement enjoys a preferential right to enter into a franchise agreement with the franchisor for a new term on the expiry of the term of the franchise agreement.

If the franchisor refuses to enter into a new franchise agreement with the franchisee (despite the preferential right), but within a year after the expiry of the term of the franchise agreement enters into a franchise agreement with a third person on the same conditions and with the same rights as the expired franchise agreement, the franchisee can claim one of the following from the franchisor:

- Transfer to the franchisee of the rights and obligations under the franchise agreement with the third person, and compensation for damages.
- Compensation for damages alone.

### Termination

21. Are there any limitations on the right of a franchisor to terminate the agreement?

#### **Termination of franchise agreement by franchisor or franchisee**

A franchise agreement can be entered into for a certain or an indefinite term, and franchise agreements that do not contain a certain term can be terminated by either party by giving at least six months' prior notice to the other party (*see Question 19*).

In addition, franchise agreements (with or without a certain term) can be terminated by either of the parties in the following ways.

The parties can provide in the franchise agreement that each party can terminate the franchise agreement by giving 30 days' prior notice if it pays compensation to the other party, the amount of which is fixed in the franchise agreement.

The franchisor is entitled to terminate the franchise agreement in full or in part if any of the following events occur, provided that the franchisor has requested in writing that the franchisee remedy the relevant breach, and the franchisee has not remedied that breach within a reasonable period of time, or the franchisee has committed a similar breach within a period of one year:

- Breach by the franchisee of the conditions of the franchise agreement on the quality of the produced goods or conducted works or services.
- Gross breach by the franchisee of an instruction or direction of the franchisor which was aimed at ensuring compliance with the character, manner and conditions of the use of the complex of intellectual property rights under the franchise agreement.
- Breach by the franchisee of its obligation to pay the fees within the terms provided in the franchise agreement.

The franchise agreement can provide for other grounds for termination of the franchise agreement by the franchisor or the franchisee.

The termination of a franchise agreement with an indefinite term and the early termination of a franchise agreement with a specific term are subject to state registration with Rospatent.

### **Contractual penalties**

Russian law allows for penalties to be agreed between the parties for certain breaches of the franchise agreement. Unless otherwise agreed in the franchise agreement, damages caused by the breach can only be claimed to the extent that they are not covered by the penalty. The franchise agreement can provide for the following regarding penalties and compensation for damages:

- The creditor can only claim the penalty, and not compensation for damages.
- Compensation for damages can be claimed in the full amount in addition to the penalty.
- The creditor can choose to claim either the penalty or compensation for damages.

22. Are post-term restrictive covenants enforceable?

In general, post-contractual non-compete restrictive covenants are not supported by Russian law, although the parties can enter into confidentiality obligations for a certain term after the expiry of the franchise agreement.

23. Can the franchisor or a replacement franchisee continue to sell to the former franchisee's customers?

As post-contractual non-compete restrictive covenants are not supported by Russian law (*see Question 22*), the franchisor or a replacement franchisee can continue selling to the former franchisee's customers.

### **Choice of law and jurisdiction**

24. Will local courts recognise a choice of foreign law in a franchise agreement for a business operating in your jurisdiction?

In principle, the Russian courts recognise the choice of a foreign law in a franchise agreement entered into between a non-Russian and a Russian party. However, the following limitations should be taken into account:

- Mandatory rules of the laws of the Russian Federation which, due to an express indication in the respective rules or due to their extraordinary importance (in particular, for the protection of rights and the legitimate interests of the participants of civil law legal relations) apply to the respective relations regardless of the applicable law.
- Provisions of a non-Russian national law will not be applied if the consequences of their application will obviously contradict the fundamentals of the legal system (public order) of the Russian Federation.
- If, on signing the franchise agreement, the essence of the relationship and its circumstances will be connected only with one state, the choice of law will not have an impact on the application of the mandatory provisions of the state with which that relationship and circumstances are connected.
- Provisions of Russian public law (for example, tax and customs laws, consumer protection laws, competition law and registration requirements) apply irrespective of the choice of national law.
- The Government of the Russian Federation can establish reciprocal restrictions to the property or non-property rights of persons of states which have established restrictions to such rights of Russian nationals.

25. Will local courts recognise a choice of foreign jurisdiction in a franchise agreement for a business operating in your jurisdiction?

In principle, the choice of a foreign jurisdiction will be recognised by local courts (*see Question 38*).

## Operations Manual

26. How does the franchisor ensure that the franchisee complies with the business standards, systems and requirements?

The franchise agreement usually provides rights to the franchisor to:

- Control the compliance of the franchisee's business with the franchisor's requirements, systems and standards (for example, by inspecting the sales premises of, or the goods, works or services sold by, the franchisee).
- Give instructions and directions which are binding to the franchisee (*see Question 14*).

The franchisee's non-compliance is usually sanctioned by the franchisor's right to claim penalties or compensation for damages, or to terminate the franchise agreement.

27. Can the franchisor change the Operations Manual unilaterally, as is usually required?

In the author's view, it can be agreed in the franchise agreement that the franchisor can change the Operations Manual unilaterally, provided that the changes are reasonable. However, as the Russian courts may take another view in order to protect the franchisee, it is recommended that the changes be approved by an additional agreement, to be signed by both parties.

## Liability issues

28. What are the franchisee's remedies against the franchisor for deceptive or fraudulent selling practices?

The franchisee can initiate proceedings to have the franchise agreement declared invalid by a court if the franchisee has entered into the franchise agreement due to the influence of fraud. The franchisor's intentional silence on a matter that he should have informed the franchisee about under the duty to behave faithfully is considered to constitute fraud. If the franchise agreement is declared invalid, the franchisor must compensate the franchisee for the damages suffered.

29. How can third-party claims against the franchisee be brought successfully against the franchisor?

## Indemnity

Under Russian law, the franchisor bears:

- Subsidiary liability for claims asserted by the franchisee's customers as a result of the insufficient quality of the goods, works or services sold by the franchisee under the franchise agreement.
- Joint liability for claims raised by the franchisee's customers as a result of the insufficient quality of goods produced by the franchisee under the franchise agreement.

Although there is little case law in this regard, in our view the franchisor's liability for the above is mandatory and cannot be excluded in the franchise agreement. Furthermore, it cannot be ruled out that it will be recognised as part of the Russian law of torts, with the consequence that it will still apply even if the franchise agreement is governed by a law other than Russian law.

Franchisors will usually wish to introduce an indemnity of the franchisee in order to protect themselves against:

- The above liability.
- The consequences of any breach by the franchisee of its obligations under the franchise agreement.
- Any further unlawful action, or failure to act, of the franchisee.

Since 2015, the Civil Code has provided for an express legal basis for indemnities. An indemnity under Russian law can provide for compensation for losses if certain circumstances occur which are not connected with a breach of the agreement (for example, losses caused by the impossibility of performing an obligation, or by claims raised by third parties). The method of calculating the losses must be described in the indemnity clause.

### **Precautions**

Most franchise agreements describe, in detail, the contractual position of the franchisee which includes an indication of its independence from the franchisor. In addition, franchisors trust that the franchisee will comply with its obligation under the Civil Code to inform customers, in the manner most apparent to them, of the fact that it uses a trade name, trademark, service mark or other means of identification on the basis of a franchise agreement (*see Question 14*).

## **Intellectual property**

30. What provisions are usually made in relation to intellectual property rights (IPRs), including know-how?

Typically, the franchisor grants to the franchisee the right to use a complex of intellectual property rights, including a trade mark, owned by the franchisor (*see Question 4*).

Usually, the franchisor reserves the right to the franchise system and the ownership of the intellectual property rights pertaining to the franchise system, including the rights to operate the business under the franchise system and the sales units, and/or to sell and distribute the goods anywhere, and to grant such rights to third parties.

If not expressly otherwise agreed in the franchise agreement, the licence granted by the franchisor to the franchisee is non-exclusive, which means that the franchisor reserves the right to use the rights itself and to grant licences to third persons. If the franchisor grants an exclusive licence to the franchisee, unless otherwise agreed, the franchisor is no longer entitled to use those rights itself.

There are no limitations on the franchisor's ability to limit the use of the intellectual property rights and confidential information solely for the purposes of the franchise system.

31. What are the registration requirements for licensing IPRs?

Licences over intellectual property rights require registration if the intellectual property rights themselves require registration. This is the case for trade marks, service marks and patents. Rospatent is the competent registration body (*see Questions 6 and 13*).

The procedures for the registration of intellectual property rights in connection with franchise agreements were facilitated with effect from October 2014. Unlike the position previously, the franchise agreement itself is no longer subject to registration, but the licence to use trade marks, service marks or patents granted under the franchise agreement must be registered with Rospatent. As a result, only limited information must be presented to Rospatent, including:

- The type of the agreement.
- The names of the parties.
- The registration numbers of the trade marks, service marks or patents.
- Type, term and territory of the licence or sublicense granted under the franchise agreement.

These amendments made Russian laws compliant with the relevant provisions of the Singapore Treaty on the Law of Trademarks 2006, which the Russian Federation signed in 2009.

Under Russian law, the franchisor must grant a licence on the use of a trademark and other intellectual property rights to the franchisee (*see Questions 4, 7, 13 and 15*). The licence must be given within the framework of the franchise agreement. If the licence to use trade marks is not registered, it is not validly granted. . However, in this event, although the agreement may not be qualified as a franchise agreement, it is not invalid as such. In particular, it will be considered effective if it provides for any of the parties' obligation to register the franchisee's licence for the use of such trade mark.

## Real estate

32. Are consents from landlords difficult to obtain when transferring leases or granting subleases from a franchisor to a franchisee?

The transfer of leases and the grant of subleases require the consent of the landlord. As there is no typical process on the grant of consent, the landlord and tenant can agree in the lease agreement that the landlord must provide its consent in certain cases (certain procedural aspects can also be agreed, for example, the time frame in which the landlord must reply to an application from the tenant). However, as landlords are reluctant to grant their consent in general and prefer to review each new sublease or each new lessee, usually the landlord will agree to an obligation to grant its consent only in exceptional cases. At a minimum the landlord will wish to reserve the right to refuse certain leases or sub-lessees.

A transfer of the lease is subject to mandatory state registration if the lease itself requires registration (which is the case if the lease term is one year or more). A sublease must be registered if its term is one year or more. The competent authority for state registration is the State Register of Real Estate Rights and Transactions. Usually registration takes ten business days. Currently, the registration duty is RUB 2,000 for individuals and RUB22,000 for legal entities.

33. How can a franchisor prevent the franchisee from occupying the premises after the franchise agreement has ended?

The parties can agree that the lease automatically terminates, or that the franchisor as the tenant has the right to terminate the lease agreement, if the franchise agreement expires or is terminated. Both alternatives are usual in practice.

34. How can the franchisor effectively acquire the franchisee's premises at the end of the franchise relationship?

Russian law provides for the following options:

- Entering into a sale and purchase agreement under which the ownership of the premises will be transferred to the franchisor at the end of the term of the franchise agreement.
- Entering into a preliminary sale and purchase agreement under which the parties are obliged to enter into a sale and purchase agreement at the end of the term of the franchise agreement.
- Entering into an option agreement under which the franchisor can request the franchisee to enter into a sale and purchase agreement at the end of the franchise agreement.

The transfer of ownership from the franchisee to the franchisor must be registered with the State Register of Real Estate Rights and Transactions (although it is not necessary to register any of the above agreements).

To further protect the franchisor's rights under any of the above agreements, a mortgage for the benefit of the franchisor can be registered at the State Register of Real Estate Rights and Transactions. The mortgage can secure the franchisor's payment claims under the franchise agreement or an agreement on the lease of the premises by the franchisee.

All of the above agreements can provide for a fixed purchase price or for a mechanism on its determination. However, if there is no provision on the purchase price the relevant agreement is invalid.

The franchisor does not need to pay an element of goodwill/going concern value to the franchisee.

35. If the franchisor leases or subleases its own site to its franchisee, can it pass on all related costs to the franchisee? Can the franchisor charge its franchisee tenant a rent expressed as a percentage of the franchisee's sales?

Under a lease or sublease of its own site, the franchisor can pass all related costs to the franchisee. In principle, the rent payable under the lease or sublease can be expressed as a percentage of the franchisee's sales. However, in determining the rent payable by the franchisee taxation should be taken into consideration. In particular, if the franchisor and the franchisee are related parties, the rent may be subject to transfer pricing control.

## Competition law

36. What is the effect of competition law rules on franchising agreements? Are there any available exemptions?

### **Competition law**

In general, obligations which are recognised as an abuse of a market dominating position are prohibited (*see Question 17*).

### **Exemptions**

See *Question 17*.

### **Online/e-commerce restrictions**

It is questionable whether online/e-commerce restrictions can be agreed in a franchise agreement. Franchise agreements are generally exempt from anti-trust restrictions (*see Question 17*). However, the Russian anti-trust authority has never formerly stated that this exemption applies to distribution channels.

## **Employment issues**

37. Can a franchisee be regarded as an employee of the franchisor?

As the parties to a franchise agreement can only be commercial organisations and citizens that are registered as individual entrepreneurs (*see Question 9*), there is no risk that the franchisee could be regarded as the franchisor's employee.

## **Dispute resolution**

38. How are franchising disputes typically dealt with? What provisions for handling disputes are usually included in domestic franchise agreements?

Proceedings before the Russian Arbitrazh courts (the Russian state courts that deal with commercial legal disputes) can usually be resolved quickly. First instance proceedings usually last approximately three months, and any further legal proceedings are usually closed within one year.

As there are no treaties providing for legal assistance between the Russian Federation and most Western states, the following is often difficult:

- The recognition and enforcement of judgments of Russian state courts in Western states.
- The recognition and enforcement of judgments of Western states in Russia.

Therefore, and in order to avoid conflicting judgments it is usually recommended that the parties agree to arbitration before an international arbitration tribunal. In many cases international arbitration tribunals have more competence to decide complicated commercial disputes.

In particular, the rules of the following arbitration tribunals are often agreed to for disputes in Western-Russian business transactions:

- Rules of Arbitration of the International Arbitral Centre of the Austrian Federal Economic Chamber in Vienna (Vienna Rules) ([www.viac.eu/en/arbitration](http://www.viac.eu/en/arbitration)).
- Rules of Arbitration of the International Chamber of Commerce ([www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration](http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration)).
- Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (<http://sccinstitute.com/dispute-resolution/arbitration/>).

As Russia is a signatory to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention), the proceedings on the recognition of foreign arbitral awards from other signatory states must comply with the rules of the New York Convention. In particular, this means that recognition can only be refused in the events described in the New York Convention (for example, the dispute is not covered by an arbitration clause, or the arbitral award conflicts with the public order of the Russian Federation).

An alternative to international arbitration is arbitration at the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (ICAC) (<https://mkas.tpprf.ru/en/>). Although the enforcement of ICAC arbitral awards requires recognition in proceedings similar to proceedings for the recognition of non-Russian arbitral awards, the proceedings are often easier.

Mediation is not mandatory. However, under the amendments made to the Commercial Litigation Code on 2 March 2016, a civil law dispute cannot be filed with the Russian Arbitrazh courts earlier than 30 days from the date when a demand letter was sent by the claimant to the defendant. However, the franchise agreement may provide for a different term.

39. How are foreign judgments or foreign arbitral awards enforced locally?

See *Question 38*.

## Exchange control and withholding

40. Are any exchange control or currency regulations applicable to payments to an overseas franchisor?

There are no restrictions regarding payments in rubles or another currency (such as euros or US dollars) by a Russian franchisee to an overseas franchisor, although Russian control and currency regulations, in principle, apply to these payments.

However, in order to track all substantial currency transactions, the Central Bank of the Russian Federation requires that, for payments under agreements with payment obligations in the amount of more than the equivalent of US \$50,000, the Russian resident wishing to effect payment must open a transaction passport at his/her Russian bank. To open the transaction passport, certain information on the agreement under which payment will be made (in particular, a copy of the agreement itself) must be presented to the Russian bank.

However, from 1 January 2018 the obligation of the Russian franchisee **[##is no longer required]** to open a transaction passport. In return for that, the franchise agreement must be registered with the **[##franchisee's]** Russian bank, if the payment obligations under the franchise agreement exceed RUB3 million.

The Russian franchisee must provide its Russian bank with a copy of the franchise agreement containing the following information:

Date and number of the franchise agreement.

Amount, currency and due date of payment obligations.

Details (in particular, name and residence) of the franchisor.

The Russian bank then registers the franchise agreement by assigning it a unique code. In general, Russian currency regulations have been streamlined over recent years and can now be regarded as additional paperwork, rather than a substantial obstacle to payments by Russian franchisees to overseas franchisors.

41. Is there a withholding obligation on payments made to an overseas franchisor?

Certain payments under franchise agreements (in particular, payments of royalties for the use of trade marks and payments for certain services) are subject to Russian VAT at the rate of 18%. If the franchisor is not registered with the Russian tax authorities as a taxpayer, the VAT due must be withheld by the franchisee from its payments to the franchisor.

Under Russian national laws, Russian franchisees must withhold profit tax at the rate of 20% from payments to overseas franchisors for the use of trade marks and other intellectual property rights. However, under most double taxation treaties to which the Russian Federation is a party (and which override national tax laws), these payments are exempt from withholding tax. The exemptions can be applied by the franchisee if the franchisor provides the franchisee with both a:

- Certificate on the residence of the franchisor in a state which is a party to such a double taxation treaty.
- Confirmation that the franchisor is the beneficial owner of the payments in question.

## Reform

42. Are there any proposals to reform the laws affecting franchising?

In 2014, a draft law was presented which provided for a disclosure obligation on the part of the franchisor. The new law contained a detailed list of the information to be provided. The franchisor had to present the information to the franchisee not later than two weeks before either the signing of the franchise agreement, or the date that the first payment was made under the franchise agreement. In the event of a breach of the disclosure obligation, the franchisee had the right to cancel the franchise agreement. However, this draft law was rejected in March 2016 on its first reading by the Duma of the Russian Federation.

### Contributor profiles

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**Areas of practice.** Franchise law; distribution; civil law.

#### **Recent transactions**

- McDonald's Russia: on the establishment of a franchise structure in Russia, including advice on the particularities of Russian franchise law and drafting a master franchise agreement and a development agreement.
- Wetzel's Pretzels: on the establishment of a franchise structure in Russia, including adapting international franchise agreements to conform with Russian law and Russian business practices.
- Engel & Völkers: on franchise agreements for the establishment of a real estate brokerage company in Russia; further review and registration of a termination agreement regarding an existing franchise agreement.

**Languages.** English, Russian, German

#### **Professional associations/memberships**

- Among the world's leading Franchise lawyers, The International Who's Who of Business and Franchise Lawyers, 2012 – 2018.
- Among the Best Lawyers for Trade Law in Russia, Best Lawyers, 2014 – 2018.
- Renowned for his "superb attention to detail, brilliant way with clients, and deep regulatory understanding", Who's Who Legal Russia Special 2014 on Distribution & Franchising.

#### **Publications**

- *Franchising: Recent Russian Court Practice, International Journal of Franchising Law, February 2018.*

- *Practical Law Global Guide Franchising in Russia 2016/2017.*
- Recent Developments in Russian Franchise Law, IBA/IFA 32nd Annual Joint Conference, "Challenges and Opportunities in International Franchising", 2016.
- *Recent Developments in Russian Franchise Law, International Journal of Franchising Law, Claerhout Publishing Ltd, Volume 12, Issue 6, 2014.*
- *Concluding franchise agreements: general regime and recent Civil Code changes, International Law Office, 10/2013 (with Mikhail Sholokhov).*
- *Franchise in Russia, Getting the Deal Through 2013 (with Natalia Babenkova).*
- *Expansion Abroad: Franchising in Important Jurisdictions of Eastern Europe, Jahrbuch Franchising 2013 (Editors: Metzloff/Böhner).*

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