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NEW FRONTIERS IN INTERNATIONAL FRANCHISING

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NEWS AROUND THE WORLD

UKRAINE

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1. BACKGROUND

Franchising is in the process of development in Ukraine. It is a relatively new notion for the Ukrainian business community as it appeared only after the collapse of the Soviet Union in the early 1990s and it had no legal framework for the following decade until the Civil Code and the Commercial Code were adopted in 2003. Furthermore, even though the Civil and Commercial Codes established a necessary platform, for another decade franchising regulation still lacked several important elements to function properly.

Ukrainian law still has a rather limited framework for the industry and the case law does not yet fully compensate for the missing components. Self-regulated non-governmental associations try to fill the void, particularly given that there has been no special governmental agency to regulate the offer and sale of franchises in Ukraine.

Despite the gaps and inconsistencies of the Ukrainian legal system, international and local franchising businesses have managed to find enforceable franchise structures or employed alternative arrangements to develop their business in Ukraine. For quite some time now, many international brands have successfully operated their franchise businesses, including, among others, Papa John's, KFC, Domino's Pizza, Baskin-Robbins and InterContinental, along with a variety of local franchises in food, retail, services and other industries. The market continues to grow. A local franchise association publicised information that more than 2,300 franchising companies are now members of the association.

The recent necessary changes in applicable laws and the new Ukrainian government's general trend of reforms towards a competitive and market-based economy give hope for further extensive development of the franchising industry in Ukraine.

In particular, such development should be significantly boosted by the recent legislative improvement in the laws with regard to problematic registration requirement for franchise agreements.

2. REGISTRATION REQUIREMENT FOR FRANCHISE AGREEMENTS

2.1 History of the problem

The registration requirement for franchise agreements has been one of the most controversial issues of franchise law in Ukraine. In 2003, Ukraine private law introduced a mandatory registration requirement for franchise agreements, both domestic and those concluded with franchisors. While, until recently, Ukrainian public law has not envisaged any procedure for registration. This posed a serious risk to the enforceability of such agreements in the Ukrainian courts and there was no completely safe means by which to comply with the registration requirement under Ukrainian law.

The Commercial and Civil Codes envisaged a registration requirement¹ for the franchise agreements. It actually required the franchisor to file for registration of the franchise agreement with state registrars, whose primary function was to administer registry of companies in Ukraine.

¹ The respective requirements for conclusion, modification and termination of franchise agreements were stipulated in Articles 367, 370 and 374 of the Commercial Code of Ukraine (effective before April 5, 2015) and Articles 1118, 1120, 1125 and 1126 of the Civil Code of Ukraine (effective before April 5, 2015).

The difficulty was that Ukrainian laws that regulate powers of the state registrars did not envisage any procedure for such officials to perform any registration actions with regard to the franchise agreements. It did not specify the duties of state registrars in this regard, terms of such registration, grounds for refusal or any other procedural details. Nor did the law specify whether a state registrar should conduct a substantive review of agreed terms before it registers a franchise agreement. There was even no register in place. For this reason, the state registrars in Ukraine refused to perform registration of the franchise agreements altogether.

Moreover, there has been no completely secure possibility to comply with the registration requirement under Ukrainian law. There was a practice where the parties to franchise agreement sent a filing to the state registrar through a notary. In this case, a notary issued a certificate for such filing. The parties then deemed to have fulfilled the registration requirement. There are also cases where the refusal of the state registrar has been challenged in the court. In many of these cases, the courts found for franchisor, but the state registrars could still delay the enforcement of the court decisions for an indefinite time by requesting a clarification on how they should comply with it without the detailed authority to do so.

The legal consequences for failure to register the franchise agreement were also disputed in the Ukrainian courts. The more common position was that the franchise agreement without registration was still valid for its parties, but may not be legitimately referred to in relations with third parties. Further, there was a practice, and it is still possible, that the Ukrainian court renders the agreement void due to lack of its registration. Thus, there is some risk to the enforceability of the franchise agreement even against the party to such agreement.

For instance, only in 2004-2014 in over 60% disputes arising of or related to mandatory registration franchising agreements, Ukrainian courts rendered franchise agreements null and void due to absence/incorrect state registration of the latter.

Given applicable serious risks, the foreign businesses used, in practice, various alternative legal structures for their franchising arrangements, such as:

1. direct distribution agreement with a foreign supplier and a distributor in Ukraine;
2. direct distribution agreement with a foreign supplier and a Ukrainian distributor, coupled with the franchise agreement with an offshore company affiliated with such distributor and personal guarantees of beneficial owners;
3. direct franchise agreement with an offshore company affiliated with the Ukrainian franchisees with personal guarantees of beneficial owners;
4. trademark licence agreement (in cases where the business was really based on the trademark and good will);
5. area development agreements;
6. parallel conclusion of several related agreements, including trademark and know-how license agreements, supply agreement and consultancy services agreement.

Franchise agreements under Ukrainian law were also practiced, but only mostly among Ukrainian business entities bearing the relevant risks and when it is just not cost-efficient to establish any foreign (offshore) structures.

Direct franchise agreements under the foreign law and with arbitration outside Ukraine were also possible. However, in case of a dispute, the issue of registration could have still been raised during the enforcement of a respective arbitration award in a Ukrainian court.

3. Recent steps to cure the gap

3.1 Decree of the Ministry of Justice approving the registration procedure

Only on 29 September 2014 the Ministry of Justice of Ukraine finally approved the procedure for registration of franchising agreements which derived from the relevant provisions of the Commercial and Civil Codes. It was supposed to take effect in 6 months after its publication (i.e. on 21 April 2015) allowing responsible state authorities to set up the new register capabilities.

According to the procedure, all franchise agreements, amendments to franchise agreements and termination agreements had to be registered in the Unified State Register of Legal Entities and Individual Entrepreneurs by the titleholder.

The registration applications, along with necessary documents, could have been submitted either directly to state registrars or electronically – through the Registration Portal of the Unified State Register of Legal Entities and Individual Entrepreneurs. After each such registration, the state registrar was supposed to issue a respective Extract from Unified State Register of Legal Entities and Individual Entrepreneurs, which would have served as a proof of registration.

The information was supposed to also be available in public domain - in particular, online on the Registration Portal of the State Register of Legal Entities and Individual Entrepreneurs.

3.2 New Law on Deregulation (repealing the registration requirement)

However, on February 12, 2015 the Ukrainian Parliament adopted the Bill On Introduction of the Amendments to the Laws of Ukraine on Simplification of Conditions for Conducting Business (Deregulation) which was later corrected and then signed by the President into law on April 1, 2015. The Law on Deregulation came into force on April 5, 2015.

The new law settles the long-standing controversy. It repeals the registration requirement for franchise agreements in both the Commercial Code and the Civil Code.²

According to the changes, all franchise agreements, amendments to franchise agreements and termination agreements are not subject to statutory state registration in Ukraine.

The law ensures that the parties may actually use the direct franchise structure that would be enforceable in the Ukrainian courts.

² See Secs. 6 and 7, Chapter II of the Law On Introduction of the Amendments to the Laws of Ukraine on Simplification of Conditions for Conducting Business (Deregulation) of 12 February 2015 № 191-VIII

4. What foreign franchisors should do now?

The foreign franchisors who have direct alternative contract structures may now prepare documents necessary to restructure existing arrangements to direct franchise agreements, which need to be reviewed and re-negotiated with the franchisees.

The franchisors that already have direct franchise agreements (despite the past applicable risks) are not required to take any specific actions. All franchise agreements with Ukrainian franchisees are now deemed valid and effective without registration.

BIOGRAPHY

Volodymyr Yakubovskyy is a partner with Nobles and chairs its commercial practice. Volodymyr has a substantial experience in representing major international corporations and leading national market players in various commercial and investment matters. He regularly advises companies on sophisticated business projects, with a particular focus on corporate, franchising and distribution matters. Mr Yakubovskyy's areas of a special expertise includes such industries like retail, e-commerce, telecommunications, IT, media, agriculture, pharmaceuticals, financial institutions and insurance. Volodymyr has written a number of articles and contributed to global law reviews on franchising, investment, e-commerce and product liability. Mr Yakubovskyy has an LLM in corporate and commercial law from the University of Cambridge, an LLM in American and international business law from Boston University and degrees in law and international law from Lviv University. He speaks Ukrainian, Russian, English and German.