

**IBA/IFA 32nd
ANNUAL JOINT CONFERENCE**

* * * * *

Challenges and Opportunities in International Franchising

* * * * *

RECENT DEVELOPMENTS IN RUSSIAN FRANCHISE LAW

—

May 18, 2016

Washington, D.C. U.S.A.

Thomas Mundry

Noerr OOO

Moscow, Russia

TABLE OF CONTENTS

1	INTRODUCTION.....	3
2	NEW CONFLICT-OF-LAW PROVISIONS (NOVEMBER 2013).....	3
3	FACILITATION OF REGISTRATION (OCTOBER 2014)	3
4	COMMERCIAL-SECRET REGIME NO LONGER REQUIRED (OCTOBER 2014).....	3
5	OWN USE NOT PERMITTED UNDER EXCLUSIVE LICENSES (OCTOBER 2014).....	4
6	PRE-CONTRACTUAL (INCLUDING DISCLOSURE) OBLIGATIONS (MARCH 2015)	4
7	OPTIONS (MARCH 2015)	4
8	SIMPLIFIED ENFORCEMENT OF THE OBLIGATION TO ENTER INTO AN AGREEMENT (MARCH 2015).....	5
9	WARRANTIES (MARCH 2015).....	5
10	INDEMNITY (MARCH 2015)	6
11	DRAFT LAW ON DISCLOSURE OBLIGATION REJECTED (MARCH 2016).....	6
12	BIOGRAPHY OF THE AUTHOR	6

1 Introduction

In the past few years, a number of amendments relevant to franchise agreements have been introduced into the Civil Code of the Russian Federation. The amendments show that the Russian legislator is endeavoring to develop the laws in order to adapt them to international standards and to facilitate their use by franchisors and franchisees. We consider all amendments to be great progress towards a reasonable Russian legal framework for franchise agreements, although in some cases the new provisions may lead to new uncertainties.

2 New Conflict-of-Law Provisions (November 2013)

If the parties to an international franchise agreement have not chosen the applicable national law, the national law of the country in which the franchisee conducts business applies. If the franchisee conducts business in more than one jurisdiction, the national law of the franchisor's main place of business applies. The main principle of Russian conflict-of-law rules has not changed, namely that the parties to an international franchise agreement are free to select the applicable national law. However, the provisions on registration procedures will be applied by the Russian authorities even if the parties have chosen another national applicable law.

3 Facilitation of Registration (October 2014)

The new law facilitates registration procedures. In deviation from previous laws, the subject of registration is not the franchise agreement, but the exclusive intellectual property right which is granted under the franchise agreement. Therefore, only limited information has to be presented to the Russian patent and trademark authority (Rospatent), including the form and subject of the agreement, the names of its parties, and the registration numbers of the exclusive intellectual property rights. These amendments make Russian laws compliant with the relevant provisions of the Singapore Agreement on the Law of Trademarks which the Russian Federation signed in 2009.

4 Commercial-Secret Regime No Longer Required (October 2014)

The subject of many franchise agreements is the granting of the use of know-how to the franchisee. Know-how is defined as a production secret of any nature that has a real or potential commercial value due to the fact that it is not known to, and cannot be freely accessed by, third parties.

The new law abolishes the former additional requirement that a "commercial-secret regime" according to the Russian law on the protection of commercial secrets must be established for the relevant production secret. The requirements of such a commercial-secret regime are very formalistic and impractical, and contain measures like the marking of the documents containing the secret, establishing rules on its protection and listing the persons who have access to the know-how. As Western businesses usually have not established such a commercial-secret regime, the fact that it is no longer required is an important improvement in the protection of know-how under Russian laws.

5 Own Use Not Permitted under Exclusive Licenses (October 2014)

The new law on license agreements (which also applies to franchise agreements) clarifies that the franchisor, in the event of granting an exclusive license to the franchisee, is prohibited from using the relevant intellectual property right itself unless the parties have agreed otherwise. Until the change in the law, based on an order of the Presidium of the Supreme Arbitration Court of the Russian Federation, the franchisor was entitled to use the intellectual property right itself unless this was expressly prohibited in the franchise agreement.

6 Pre-Contractual (Including Disclosure) Obligations (March 2015)

Parties which are negotiating on entering into a franchise agreement are obliged to act in good faith. A party which is in breach of this obligation is obliged to compensate the other party for damages suffered. The new law mentions the following examples of failing to act in good faith:

- starting or continuing negotiations without intending to enter into an agreement,
- unexpected or unjustified termination of negotiations in circumstances in which the other party may not have expected termination,
- providing incomplete or untrue information or failing to disclose information which, according to the character of the planned agreement, should be known by the other party.

For franchisors, the obligation to provide adequate information is important. Although Russian courts will probably not interpret that obligation as a basis for detailed disclosure obligations as existing under US laws, franchisors should be prepared to provide more detailed business information to future franchisees than under the previous laws.

In order to overcome the uncertainties of the new laws, it is generally recommended that future parties to a franchise agreement enter into an agreement in which the pre-contractual obligations are specified. Such an agreement is expressly permitted under the new laws, provided, however, that the liability for action in bad faith or non-action is not limited.

7 Options (March 2015)

Options play an important role in franchise agreements. Often the franchisor is granted the option to extend its activities (e.g. to open further shops or restaurants) or to extend the term of validity of the franchise agreement if certain business goals are achieved. On the other hand, upon termination of the franchise agreement, the franchisor has often the option to re-purchase the stock supplied to the franchisee but not re-sold to the customers.

Under the previous law, options could be structured as offers made by the option grantor which could be accepted by the option grantee, or as preliminary agreements with the option grantor being obliged to enter into an agreement on the performance of the respective option. However, there was no certainty regarding the lawfulness of options which may be exercised only on certain conditions (e.g. the achievement of certain business goals). Many Russian courts deemed such options invalid if the occurrence of the condition was dependent on the will of one of the parties.

The new law expressly recognizes options. It permits one party to make the other party an irrevocable offer to conclude an agreement by way of accepting the offer and states that the offer may be accepted only on certain conditions, the occurrence of which depends on the will of either of the parties. At the same time, the Supreme Court of the Russian Federation has recently acknowledged the structure of conditional options as described above.

In addition, the new law provides for “option agreements”, which are agreements under which one party is granted the right to request that the other party take certain actions (e.g. payment of transfer or acceptance of goods) within a certain period. The option agreement expires if the respective action is not requested within the agreed period. It is not entirely clear why Russian law provides for the option agreement in addition to the option, as any action may be structured as an agreement on taking the respective action. That is probably the reason why one draft of the new law provided only for option agreements designed as options under the new law.

8 Simplified Enforcement of the Obligation to Enter into an Agreement (March 2015)

The new law substantially facilitates the enforcement of an obligation to enter into an agreement and is therefore another important step towards creating a reliable legal basis for options under Russian law. Previously, it was only specified that the creditor of a claim for entering into an agreement may file a lawsuit against the debtor. This was not very helpful as it did not specify by which means the claim may be enforced.

The new law states that the agreement is deemed to be concluded when the decision of the relevant court enters into force. This solution is as simple as it is efficient. An excellent new provision!

9 Warranties (March 2015)

Similar to the concept of warranties in Anglo-American legal systems, Russian law provides for liability for compensation for damages or payment of the agreed penalty by a party which prior to, upon or after the entering into an agreement, gave incorrect confirmation of circumstances which are important for the conclusion, performance or termination of the agreement. Astonishingly, the conditions for liability are as follows:

- That the confirming party assumed or had reasonable cause to assume that the other party would rely on the confirmation, and
- That the confirming party knew that the confirmation was incorrect.

It is hard to understand why the liability of the confirming party should be subject to the aforementioned conditions. Usually a party who makes confirmations should assume that the other party trusts in the confirmations and it should make confirmations only if it is sure that they are correct. Interestingly, the law does not require the fulfillment of the above conditions for warranties in shareholders' agreements and agreements on the sale and purchase of shares.

Furthermore, an incorrect confirmation triggers liability even if the agreement which contains the confirmation is recognized as not concluded or invalid. That is, if at all, comprehensible only for confirmations which concern the validity of the agreement (e.g. the power of attorney of the signatory, or the existence of all required corporate approvals or approvals by

third parties). However, regarding the validity of powers of attorney, it seems to be unreasonable that a party may be held liable for confirmations by its non-authorized attorney.

10 Indemnity (March 2015)

Similar to the concept of indemnity in Anglo-American legal systems, the parties may agree in franchise agreements that a party is obliged to pay compensation for economic losses which it suffers due to certain circumstances unconnected with a breach of the agreement. The law mentions the following examples:

- impossibility of performance of an obligation,
- claims by third parties (e.g. governmental authorities) against the indemnifying party or third parties.

The indemnity clause must provide a basis for calculating the economic loss. In deviation from previous draft laws, there is no reference to the general provisions on calculating damages if the indemnification clause contains no basis for calculating the economic loss. We consider the lack of such a reference to be reasonable, as an indemnity is not a liability for unlawful action or non-action, but compensation for economic loss upon the occurrence or non-occurrence of certain circumstances. For this reason, it is also understandable that, in contrast to contractual penalties, a court is not entitled to reduce the amount of the indemnification.

As for warranties, the law provides that the indemnification clause is valid even if the agreement which contains the indemnification clause is recognized as not concluded or invalid. Please refer to our comments on the corresponding provision in section 9 above.

11 Draft Law on Disclosure Obligation Rejected (March 2016)

In 2014, a draft law was put forward 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 prior to either the signing of the franchise agreement or the first payment to be 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. The draft law was rejected in March 2016 on its first reading by the Duma of the Russian Federation.

Biography of the author

Dr. Thomas Mundry has worked as a lawyer in Moscow since 1994, where he has gained substantial experience in investment and other projects for Western and Russian companies in the Russian Federation. Dr. Mundry advises on national and international franchise structures, distribution and sales to and from Russia for numerous businesses and is a frequent speaker and author on IP and franchise issues. He has advised numerous international franchisors on establishing franchise structures in Russia, including McDonald's Russia, Wetzel's Pretzels,

Nordsee, Tally Weijl Trading, Arcadia Group, Mamas & Papas, Realogy Corporation and Engel & Völkers. He is listed among the world's leading franchise lawyers in The International Who's Who of Franchise Lawyers 2012 and The International Who's Who of Business Lawyers 2012 – 2015 and among the Best Lawyers for Trade Law in Russia in Best Lawyers 2014, 2015. He publishes and speaks regularly on Russian franchise law.