

Franchise

in 32 jurisdictions worldwide

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Overview

1 What forms of business entities are relevant to the typical franchisor?

The most common forms of business entities used by franchisors in Russia are the limited liability company (LLC) and the joint-stock company (JSC). Shares in a JSC can be publicly held and sold to a third party without offering them to other shareholders – the ‘open JSC’ – or held only by a limited number of shareholders (up to 50) and sold to other third parties in case other shareholders have not executed their pre-emptive right only – the ‘closed JSC’. Although these entities play a major role in practice, the Civil Code of the Russian Federation (CCRF) also provides several different company structures, such as general or limited partnerships, which may also, under certain circumstances, be an appropriate legal form for conducting a franchise business.

Over the past few years, foreign franchisors have recognised wholly owned Russian subsidiaries as a relatively easy way of expanding their business into the Russian market. Among the two leading legal forms of Russian entities, the LLC appears to be more popular owing to the fact that it is easier to establish and the operation of an LLC is less time-consuming. Nevertheless, under some circumstances a JSC might be the more appropriate choice for an investor, for example in certain joint-venture structures.

2 What laws and agencies govern the formation of business entities?

The CCRF is the basic law concerning legal forms in Russia. Additionally, LLCs and JSCs are governed by special laws; for example, the Federal Law on Limited Liability Companies No. 14-FZ of 8 February 1998 (the LLC Law) and the Federal Law on Joint-stock Companies No. 208-FZ of 26 December 1995 (the JSC Law). Transactions involving shares are additionally governed by the Law on the Securities Market.

According to the Federal Law on State Registration of Legal Entities, which came into force in 2002, the local bodies of the Federal Tax Service of the Russian Federation (the registration authority) are responsible for the state registration of legal entities in Russia and make respective entries into the Unified State Register of Legal Entities. JSCs must in addition register their share issues with the Federal Service of Financial Markets.

3 Provide an overview of the requirements for forming and maintaining a business entity.

A LLC or JSC may be founded by one or more persons or legal entities. However, a sole shareholder that is a legal entity of either a Russian LLC or JSC may not in turn be owned by a sole shareholder that is also a business legal entity. The initial minimum share capital of a LLC and a closed JSC is currently 10,000 roubles. The initial minimum share capital of an open JSC is 100,000 roubles.

The number of shareholders in a LLC and in a closed JSC may not exceed 50. Once that number is exceeded, the JSC has to be transformed into an open JSC and the LLC has to be transformed into an open JSC or a production cooperative within one year.

As far as the registration of a company is concerned, for LLCs the following documents have to be collected, drafted and filed as one package with the registration authority:

- an application form signed by a director of the founding entity or entities before a notary;
- the resolution of the founders’ meeting;
- the company charter;
- confirmation of the legal status of the founders: for example, trade register excerpt, certificate of incorporation regarding legal entities;
- confirmation of payment of the state registration fee (approximately US\$80); and
- guarantee letter regarding the future lease from the owner of the premises to be used as a corporate seat by the new LLC.

Documents from a founding foreign legal entity must be notarised and additionally certified (usually apostilled) in the country of execution.

After registration with the federal tax service, which takes five working days from the filing of the required documentation package, the newly established legal entity has to be registered additionally with the mandatory social funds and the state statistics committee. An official company seal (stamp) must be obtained and a permanent bank account in Russia must be opened before starting business operations.

The whole registration procedure of a LLC takes about three to five weeks and costs approximately US\$100 in state fees. The professional fee for the entire process of preparing and presenting the documents to the registration authorities will typically add between US\$3,000 and US\$10,000. Establishment of a JSC is more time-consuming owing to the necessity of additionally registering the share issues with the Federal Service for Financial Markets. Taking into account the rather bureaucratic registration procedure and often-changing details of legislation and filing rules, it is advisable for a foreign investor to use the services of experienced professionals to successfully and rapidly get through the registration procedure.

4 What restrictions apply to foreign business entities and foreign investment?

Foreign investments are mostly regulated by the Federal Law on Foreign Investments (1999) and the Federal Law on Strategic Enterprises (2008) in the Russian Federation. The Federal Law on Foreign Investments guarantees foreign investors the right to invest and to receive revenues from investments in Russia. To attract foreign capital, technology and other assets, the Law on Foreign Investments

states that foreign investors and investments must not be treated less favourably than domestic ones. However, there are some exceptions, for example, concerning protection of the Russian constitutional system, state security and state defence, as well as sensitive industries, ownership of agricultural land and participation in so-called strategic enterprises. The Federal Law on Strategic Enterprises provides for definition and detailed investment regulations regarding strategic enterprises, but such provisions do not usually affect the franchising business.

Russian currency control regulations have been significantly simplified in recent years and can now be regarded as additional paperwork rather than as a real obstacle to transferring money. Foreign investments can usually be repaid without any problems. However, it must be taken into account that Russian commercial banks are still in charge of currency control when conducting money transfers on behalf of their clients, and much paperwork must be done before a transfer from the currency control perspective.

- 5** Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

Tax legislation in Russia does not distinguish between franchising and other forms of business. When a Russian legal entity is established to run franchising activities, the franchising fee is subject to Russian VAT (18 per cent of the turnover) and corporate income tax (20 per cent of the difference between income and business expenses). Russian franchising companies are also subject to other taxes, which all businesses in Russia have in common, such as withholding obligations regarding personal income taxes and social fund contributions imposed on personnel salaries, property and land taxes, etc.

If a franchising business is organised in Russia through the permanent establishment of a foreign entity, taxation of the foreign entity is similar to that of a Russian legal entity (so the permanent establishment must charge 18 per cent VAT on its franchising fee, pay corporate income tax, etc). The important question, however, is whether a permanent establishment can deduct from its taxable income business expenses incurred not only in Russia, but also abroad. This issue should be analysed in each particular case.

If a franchising business is organised in the form of a cross-border franchise contract between a foreign franchisor and a Russian franchisee (when the franchisor has no presence in Russia), the major taxation rules are applicable.

Under Russian tax law, services rendered within a franchising agreement are in general recognised as rendered in Russia if the franchisee is a Russian company. Thus, when paying a franchising fee to a franchisor having no permanent establishment in Russia, a Russian franchisee must withhold Russian VAT at the rate of 18 per cent. This VAT withholding obligation cannot be avoided in a cross-border franchising structure. The Russian franchisee can subsequently recover this VAT (it is deductible against sales VAT).

Franchising fees under a cross-border franchising agreement can be subject to Russian income tax withholding (20 per cent tax rate). However, a foreign franchisor can benefit from any double tax treaty made between Russia and the country where the franchisor is recognised as a tax resident. Currently, Russia has a wide network of such treaties and, as a rule, such treaties establish tax exemptions in Russia as regards royalties and other incomes typical for franchising relations. According to Russian tax legislation, the exemptions provided by double tax treaties may be applied only in cases where the foreign company that receives the income provides confirmation that it has a permanent legal land tax residency in the respective state.

- 6** Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

The Labour Code of the Russian Federation is the core legislation concerning employment issues. Foreign franchisors have to be aware that the Russian Labour Code provides all employees with minimum guarantees that cannot be superseded by any other agreement, since the Russian Labour Code is mandatorily applicable to all employees in the territory of the Russian Federation. Any employment contract has to be in writing and is generally entered into for an indefinite period of time. However, a probationary period of up to three months can be established for newly hired employees (up to six months for CEOs or CFOs, that is, employees having the position of general director or chief accountant).

Russian law significantly limits cases where the conclusion of labour contracts with a certain term is allowed. In most cases, labour contracts must be concluded for an unlimited (unspecified) period of time and Russian employees may terminate such labour contracts at any time upon giving two weeks' notice. The grounds for an employer to fire an employee are very limited.

Employees in Russia have a labour book containing certain information on their employment history necessary for obtaining state-provided pensions and other social benefits. Employers are responsible for making all recordings in a timely fashion to avoid employees' indemnification claims.

The employer is specified in the labour agreement and the labour book. According to Russian legislation, the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor is usually ruled out.

In order to employ a non-Russian citizen, the employer usually needs a framework permit for the employment of a specified number and type of foreign professional, and each foreign employee needs to obtain a personal working permit. The framework permit for the employer is often limited by a received quota, which must be filed before May of the previous year: thus, obtaining working permits is a very bureaucratic procedure that must be prepared in advance. However, from July 2010 Russian legislation simplified the working permit procedure for 'high-qualified' employees whose annual income is at least 2 million roubles. The procedure for employing citizens of CIS countries is also simplified.

- 7** How are trademarks and know-how protected?

As of 1 January 2008, most regulations on the protection of trademarks and know-how (ie trade secrets) are set forth in Part 4 of the CCRF. Russia is also a signatory to major international treaties on intellectual property rights, including the Paris Convention for the Protection of Industrial Property, the Patent Cooperation Treaty, the Madrid Agreement on the International Registration of Trademarks and the Protocol to the Madrid Agreement. Trademark registration with the Federal Services for Intellectual Property, Patents and Trademarks (Rospatent) is deemed a condition for protection of a trademark.

Know-how does not require registration and protection exists from the moment of its creation. Know-how is protected as long as it is kept secret, but therein lies its major disadvantage: if the secret information is disclosed to a third party, whether inadvertently or maliciously, all protection is lost. Thus, protection depends on the reliability of the parties who sign the confidentiality agreements and are given access to the information related to know-how.

The CCRF sets forth a wide range of protection measures for trademark and know-how infringement: indemnification for losses, contractual damages and penalties, deregistration (nullification) with Rospatent and court decisions on the prohibition of certain actions, etc. Exclusive rights to trademarks and know-how can, under certain

circumstances, be protected through the norms of the antimonopoly law.

8 What are the relevant aspects of the real estate market and real estate law?

The CCRF, the Land Code of the Russian Federation of 2001 and other legislation regulate transactions regarding land and other real estate. Land plots and buildings are treated in Russia as separate entities (objects) of real estate property. Acquiring ownership or a lease of real estate in Russia is a complex process because of the registration requirements, especially when the real estate is state-owned (non-privatised). Ownership, a long-term lease (more than one year), mortgages and some other titles to real estate and transactions are subject to state registration with the Unified State Register of Rights to Real Estate and Transactions (Real Estate Register).

Generally, landownership by foreigners is allowed under Russian Law. Exceptions regarding foreigners and companies, in which foreign ownership constitutes 50 per cent or more, apply for special territories like border areas and agricultural land. In addition, a number of general prohibitions on privatisation of land (applying to both foreign and local entities) are stipulated in the Russian Law on Privatisation, as well as in the Land Code. In most cases where privatisation is not allowed, state-owned land may be leased under a long-term lease agreement that can provide enough legal assurance to the investor. Non-privatised land and buildings can be leased for a maximum term of 49 years; in practice most leases of commercial real estate properties do not exceed 10 years.

Private parties may negotiate the terms of leases themselves. For the sale and lease of non-privatised land and buildings, basic commercial conditions are set forth by either federal or local laws. For example, the rent under a land plot lease agreement with a local authority is usually calculated according to a specific formula endemic to the region. It is worth noting that an owner of a building located on non-privatised land is generally entitled either to lease or to acquire the land plot under this building. The purchase price for such an acquisition is regulated by federal law and can be specified by the local law.

Verification of a title to real property is based on the Real Estate Register, the information in which is publicly available in the form of extracts regarding certain real estate property and is provided to any person upon application to the Federal Registration Service. However, Russian law provides only limited good faith protection to the acquirer, and verification of additional documents confirming the title is highly advisable.

Investors should seek experienced advice from professionals to avoid problems when acquiring and leasing real property.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

Franchise agreements are expressly regulated by the CCRF and are called ‘commercial concessions’, while the franchisor is called the ‘rightholder’ and the franchisee is called the ‘user’. According to article 1,027 of the CCRF, the franchisor must grant the franchisee, against remuneration and for a defined or undefined period of time, the right to use trademarks or service marks and (optional) rights to use other intellectual property rights; in particular, the right to use know-how.

For a trademark to be licensed to a franchisee it must already be registered with the Rospatent or WIPO, with Russia designated as the registrant country before execution of the franchise agreement. The franchise must be used by the franchisee for its entrepreneurial activities.

It should be noted that as of 1 January 2008, the right to the company name is no longer a mandatory aspect of franchise

agreements. Since that date a franchise agreement must provide the franchisee with a set of exclusive rights, including the right to conduct business using the franchisor’s trademark. The latter makes franchise agreements even more similar to licence agreements for trademarks, which are regulated separately by Russian law and are often used as a contractual form for franchising instead of the real franchising agreements (namely, a ‘commercial concession’ agreement).

According to the wording of the CCRF, the main difference between a franchising agreement and a licence agreement is that the franchising agreement establishes the granting of a number of exclusive intellectual property rights while a licence agreement establishes the granting of one intellectual property right, and in addition to exclusive rights, the franchisee can use the goodwill and commercial experience of the franchisor within the framework established by the franchise agreement.

10 Which laws and government agencies regulate the offer and sale of franchises?

Russia has one of the few legal systems in the world where statutory provisions regulate the entire franchise relationship. The governing provisions are those laid down in chapter 54 (articles 1,027 to 1,040) of the CCRF and general provisions of chapter 69 on licence agreements (articles 1,235 to 1,238).

Before 1 January 2008 franchising agreements were subject to double state registration – one with the Russian tax authority and another one with Rospatent. On 1 January 2008 the requirement of registration with the tax authorities was eliminated.

Under Rospatent regulations, the registration authority has to register a franchise agreement within two months if the parties have provided all relevant information and documents. In practice, registration takes much longer. The state registration fee is the same as for licence agreements on trademarks (service marks) and depends on the number of trademarks to which exclusive rights are to be granted: approximately US\$250 per trademark.

11 Describe the relevant requirements of these laws and agencies.

A franchise agreement may only be concluded between business organisations or individuals acting as registered individual entrepreneurs. The agreement has to be concluded in writing and registered with Rospatent. A contract that is not registered with Rospatent is deemed invalid.

The registration requirement applies not only to conclusion of an agreement, but also to amendments and its termination.

Another significant requirement is that the franchisor must provide the franchisee with the technical and business documents (booklets, manuals on operating standards in which the know-how relating to the franchise system and the methods according to which their business is operated are summarised) and other information that may be necessary for the franchisee and its employees on issues related to the exercise of the rights granted under the franchise agreement. Unlike other jurisdictions, however, the extensive regulations on franchise agreements in chapters 54 and 69 of the CCRF do not include provisions on the franchisor’s obligation to provide information prior to concluding the agreement. Whether or not this obligation arises from the general rules of the CCRF is subject to judicial clarification.

As a first step, Rospatent verifies whether the submitted set of documents is complete. As the second step Rospatent verifies whether the provisions of the franchise agreement are in line with mandatory requirements of Russian law and with each other.

Rospatent is basically not entitled to establish new regulations for the content of franchising agreements. Most of this agency’s requirements relate to the form and detail of documents subject to filing and technical matters of registration.

12 What are the exemptions and exclusions from any franchise laws and regulations?

The CCRF franchising regulations apply to all legal entities and individual entrepreneurs and do not contain any exemptions or exclusions for any particular reason. However, cross-border contracts may include a choice of law clause that may declare a different legal system applicable. Nevertheless, 'super-mandatory' (public policy) provisions of Russian law are applicable even when a foreign governing law is chosen. Given the lack of judicial decisions, it is not possible to list all the provisions that may be categorised as 'super-mandatory' by Russian courts. Russian registration requirements must be applicable as such super-mandatory provisions, in any case.

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

There are no such requirements. The only requirement is that a franchisor and a franchisee must be business organisations or individuals acting as a registered individual entrepreneur.

14 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

As mentioned above, the CCRF does not include specific provisions on a franchisor's duties to provide information prior to concluding an agreement. Nevertheless, the franchisor has to provide the franchisee with all information required to exercise the rights granted once the contract is concluded. The sub-franchisor must make the additional disclosures to sub-franchisees.

In general, the terms of the agreement between a franchisor and a sub-franchisor do not have to be disclosed to the sub-franchisee. This excludes any information that is essential to the sub-franchisee, such as intellectual property rights and rights to grant sub-franchising that a (sub-) franchisee would usually require as confirmation of the (sub-) franchisor's authority to enter into the respective agreement.

15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

As mentioned above, pre-contractual disclosure is not explicitly specified in the CCRF. Because of legal uncertainty, potential franchisors should provide general information on the franchising scheme and other minimum requirements through pre-contractual disclosure. In the absence of an explicit provision on disclosure updates, it is advisable to update the information provided on a regular basis, because it is the franchisor's duty to provide the 'required' documents.

16 What information must the disclosure document contain?

The legislation adopted in Russia does not regulate disclosure in any detail. However, article 1,031 of the CCRF provides that the franchisor must furnish its franchisees with technical and commercial documentation (booklets, manuals on operating standards in which the know-how relating to the franchise system and the methods according to which their business is operated are summarised) and other information that may be necessary for the franchisee and its employees on issues related to the exercise of the rights granted under the franchise agreement. Note that such disclosure is generally not pre-contractual, as presented above.

17 Is there any obligation for continuing disclosure?

Russian franchise law requires the franchisor to render continuous technical and consulting 'assistance' to the franchisee, including assistance in the ongoing training for its employees, unless the franchise agreement provides otherwise. Thus, unless excluded by the franchise agreement, the franchisor has an obligation to disclose information as part of this continuous assistance. There is no other continuing disclosure obligation on the part of a franchisor.

18 How do the relevant government agencies enforce the disclosure requirements?

See questions 10, 11, 15, 16 and 17.

19 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

As mentioned above, the CCRF does not include specific provisions on franchisors' duties to provide information prior to concluding an agreement. In cases where the franchisor commits a substantial violation of disclosure requirements provided in the contract or resulting from the regulations on general contracts in the CCRF, or both, the franchisee may claim termination of the franchise agreement before a court (rescission by judicial decision). In the event of losses suffered by the franchisee through the franchisor's respective actions, the franchisee is entitled to claim damages. The damages under Russian law include actual losses and lost profits. The contractual damages can be limited by a certain amount, except in the case of intentional damages.

20 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Liability for disclosure violations is not shared between the franchisor and sub-franchisor unless otherwise agreed by the respective parties in writing. Each party must file damage and other claims within its respective contractual relationship. Individual officers, directors and employees are usually not exposed to liability. However, according to article 1,034 of the CCRF, the franchisor bears secondary responsibility in the case of third-party claims against a franchisee concerning the quality of the goods (or work or services) being sold (or fulfilled or rendered) by the franchisee in accordance with the franchise contract. For goods produced by the franchisee, the franchisor may bear joint and several liability with the franchisee.

21 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

The offer and sale of franchises is generally affected by the principles of contract law that are part of the CCRF. Under some circumstances, and depending on the transaction structure, the offering and selling of franchises can be subject to the Federal Law on Advertisement and Russian anti-monopoly regulations (Federal Law on Competition Protection and other legal acts), and the specific consent of the Russian Federal Antimonopoly Service may be additionally required. Depending on the subject matter of the franchise, franchised activities can also be subject to regulations on the certification of certain goods and services, licensing and similar requirements.

- 22** Are there any general obligations for pre-sale disclosure that would cover franchise transactions?

As mentioned above, the CCRF does not include specific provisions on a franchisor's duties to provide information prior to concluding a franchise agreement.

- 23** What other actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

According to the general provisions of Russian legislation, the franchisee is entitled to demand termination of the franchise contract in court and to claim damages if the actions of the franchisor do not conform to the legislation of the Russian Federation. In rare cases, for example for fraudulent practices, it may be advisable to initiate criminal proceedings against the franchisor.

Legal restrictions on the terms of franchise contracts and the relationship between parties involved in a franchise relationship

- 24** Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Except for the CCRF, such legislative regulation does not exist in the Russian Federation.

- 25** Do other laws affect the franchise relationship?

In addition to the CCRF, franchising is affected, inter alia, by laws on competition, intellectual property law, consumer protection laws and tax law. Real estate regulations can also be an issue.

- 26** Do other government or trade association policies affect the franchise relationship?

The Russian Franchise Association (RFA) has endorsed a mandatory code of conduct for its members; this may affect the franchise relationship and the way that members of the RFA may behave in a franchise relationship. Membership of the RFA is voluntary and the RFA has no statutory authority or power. There are no criteria for becoming a member of the RFA; it is relatively easy to become a member upon paying a rather small membership fee. More information about the RFA can be found on its website (www.rarf.ru).

- 27** In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The circumstances surrounding the termination of a franchise relationship are the same for the franchisor and the franchisee. If an agreement has been concluded for an indefinite duration period, both contracting parties are entitled to terminate the contact by giving six months' notice. According to the wording of the provision of the relevant law, the period of notice may not be shortened, but can be extended.

Notice of ordinary termination is, unless otherwise agreed in the respective contract, excluded where a fixed-term agreement is concerned. In addition, there is a right of termination on extraordinary grounds (significant contractual violations) by judicial decision. To avoid disputes, and since it may take some time to obtain a court decision, it is advisable to specify in the contract the grounds for an extraordinary non-judicial termination at the parties' own discretion, or at least to define the criteria that constitute extraordinary grounds.

Furthermore, franchise agreements are terminated by law in the event of insolvency of one of the contracting parties. Since 1 January 2008, if the right of the franchisor to a trademark, service mark or trade designation is terminated, and provided that this right is part of the complex of exclusive rights granted to the franchisee under the franchise agreement and this terminated right is not substituted with an equivalent right, the franchise agreement can be terminated by the franchisee as well.

- 28** In what circumstances may a franchisee terminate a franchise relationship?

See question 27.

- 29** May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Generally, the franchisee is entitled to demand the renewal of the franchise agreement under the terms and conditions of the previous (expired) franchise agreement. The sole prerequisite is that the franchisee has duly fulfilled its obligations under the previous franchise agreement.

The franchisor is allowed to refuse the renewal only if it decides not to grant to any person the franchise on the respective territory. Should the franchisor decide afterwards, but before the expiration of the three-year period, to conclude a franchising agreement with regard to the respective territory, it shall offer the former franchisee renewal of the expired franchising contract. It is possible to reduce the risk related to the franchisor's obligation to renew under the terms and conditions of the previous (expired) franchise agreement by limiting the contractual territory.

- 30** May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

The franchisee's right to transfer the franchise may be granted or excluded in the franchise contract. A franchisor may not restrict transfers of ownership interests in a franchisee's entity unless the franchisee has sold or pledged to the franchisor a certain share in its entity. The franchise contract may provide the right to terminate the contract in that case or in other cases of change of control. However, this ground for termination has not been significantly tested in Russian courts.

- 31** Are there laws or regulations affecting the nature, amount or payment of fees?

The conclusion of a franchise agreement must contain an agreement on remuneration according to article 1,027 of the CCRF. Details of the remuneration are to be specifically agreed on by the contracting parties. Article 1,030 of the CCRF provides the following examples: fixed non-recurrent or regular fees, deductions from proceeds, or a mark-up on the wholesale prices where goods are supplied by the franchisor. These forms of remuneration may be combined with each other, or parties may stipulate other forms of remuneration. In cross-border franchising agreements, the Russian franchisee may be obliged to withhold Russian taxes on behalf of the foreign franchisor, in particular VAT or withholding tax, or both (see question 5).

- 32** Are there restrictions on the amount of interest that can be charged on overdue payments?

The legislation does not specifically set a cap on the amount of interest. However, in accordance with article 333 of the CCRF, the contractual penalties can be minimised by a court if it finds that they are not appropriate and do not correspond to the violation. Russian

state courts tend to interpret excessive interest rates on overdue payments as contractual penalties and recognise them up to a certain limit (usually a bit higher than the current refinancing rate of the Russian Central Bank or the level of inflation, or both).

33 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Where cross-border franchising is concerned, payments may be made in a foreign currency, including the franchisor's domestic currency.

If the franchisor and the franchisee are Russian legal entities or entrepreneurs, payments may be made only in roubles. However, a local franchise agreement may provide for the setting of fees in a foreign currency and their payment in roubles at a certain exchange rate.

34 Are confidentiality covenants in franchise agreements enforceable?

The CCRF already stipulates that the franchisee must not disclose confidential information provided by the franchisor. Confidentiality covenants in franchise agreements are enforceable if they are drafted in sufficiently clear language and the confidential information is treated by the providing party in line with specific Russian legal requirements regarding know-how (trade secrets).

According to the CCRF, know-how includes knowledge of any kind (eg relating to the product, technical, business-related, or operational processes), as well as the results of intellectual processes in scientific or technical areas and expertise in the processes of business activities, if they have a real or potential economic value due to the lack of their knowledge by third parties; if third parties have no legal access to them; and if they are classified as trade secrets by the entitled person.

A set of information is considered a trade secret after the franchisor has:

- created a list with information representing the trade secret;
- limited access to that information by erecting rules of procedure to regulate the use of the information and ways to control it;
- registered all persons with access to the information and persons who will be provided with access in the future;
- regulated the handling of information by entering into agreements with employees and business partners; and
- documented the trade secret information and applied an annotation 'trade secret', including the name and address of the entitled rightholder.

Since it is often difficult to prove specific damages related to disclosure, it is advisable to stipulate contractual penalties for breach of confidentiality obligations.

35 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Good faith is a general legal principle in Russian law. However, there is presently no case law at the highest court level concerning franchising based on this principle.

36 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

There is no such law.

37 Must disclosure documents and franchise agreements be in the language of your country?

In practice, yes, because registration of a franchise agreement with the Rospatent requires a Russian version or a certified translation.

In cross-border contracts, an original in the Russian language is not obligatory, but it is advisable to execute a bilingual version of a franchise agreement. With regard to disclosure documents, it is not obligatory but is recommended to have a Russian version (or at least a reliable translation) to avoid unnecessary disputes with franchisees who are not fluent in foreign languages and authorities that are controlling business operations.

38 What restrictions are there on provisions in franchise contracts?

The CCRF prohibits, for example, provisions by virtue of which the franchisor has the right to determine the price of the sale of the goods by the franchisee, the price of work (or services) being performed (or rendered) by the franchisee or an upper or lower limit on these prices. There are other restrictions on provisions in franchise contracts that apply by law but, owing to the variety of legal arrangements, these are beyond the scope of this questionnaire.

39 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

Competition law in Russia is mostly contained in the Law on the Protection of Competition, which came into effect in October 2006. In July 2009 the Russian Competition Law was amended – for a long time it had been expected that special rules for vertical agreements relating to franchising would be enacted.

The amended Competition Law basically sets forth the exemptions regarding franchising agreements' contractual terms and conditions (other than limitations for monopolists and dominant business entities, which are usually not relevant for franchising). This liberalisation of competition law with regards to franchising may however, only be for the short term, since new amendments to the law could be enacted.

It should be noted that the CCRF prohibits the inclusion of provisions in franchise agreements that provide limitations through predefined groups of customers or territory, and the setting of prices. Violation of these restrictions can lead to partial or full invalidity of the agreement (depending on whether or not the respective illegal limitation is considered by the parties to be a substantial term).

Russian franchise law expressly permits franchise agreements to contain certain restrictions:

- dedication: the franchisee may be obligated not to accept, from any competitor or potential competitor of the franchisor, any rights similar to those it has accepted from the franchisor;
- location: the franchisee may be obligated to obtain the franchisor's consent for the specific location(s) of the commercial premises to be used by the franchisee in operating the franchisor's business; and
- design: the franchisee may be obligated to obtain the franchisor's consent for the external and internal design of the premises, clothing of the personnel, cooking batteries or plates, or all of the above.

40 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Russian judicial system consists of the Constitutional Court, the courts of general jurisdiction and the state arbitrazh (commercial) courts. The courts of general jurisdiction hear criminal cases, civil disputes between individuals, and disputes arising from administrative relationships among individuals and state bodies.

Franchising issues are heard before the state arbitrazh courts, where disputes regarding business activities are resolved. The procedural rules applicable in the Russian state arbitrazh courts are based on the general principles of procedural law adopted in continental Europe. With certain exceptions, the procedure is inquisitorial. One of the main advantages of state arbitrazh courts is a trial period of

Update and trends

The most recent major changes related to franchise law were introduced in 2008–2009. The simplification of employment of highly qualified foreign employees has been a major development in 2010.

only a few months, since the courts generally must consider cases within three months of receipt of the application.

The enforcement of Russian state court rulings is carried out by the bailiff service. A foreign state court judgment may be enforced in Russia if such a judgment has been recognised by a Russian court, which will only be the case if international treaties apply or reciprocity is ensured.

Unlike in other jurisdictions, there has been very little practice of mediation and other forms of alternative dispute resolution in the Russian Federation. Russian mediation law was adopted at the end of July 2010 and will enter into force as of 1 January 2011. The application of mediation is limited by a number of conditions.

Foreign companies may refer disputes to a private arbitration tribunal located either within or outside of Russia. Awards issued by international arbitration can be enforced in Russia after their recognition by a Russian state arbitrazh court. The recognition procedure is stipulated by law in accordance with the New York Convention of 1958 on the Recognition and Enforcement Of Foreign Arbitral Awards.

- 41** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

The major advantage of arbitration is the arbitrators' experience with cross-border agreements, especially when a matter is governed by a foreign law. Unfortunately, Russian judges in state courts are often not that familiar with handling contracts governed by non-Russian laws. The independence and incorruptibility of the arbitrators is also an issue: from time to time, corruption can still be seen in Russian state courts of the first and second instance, despite the government's anti-corruption measures.

On the other hand, Russian state courts are usually very fast in taking decisions (between one and six months in each instance) and their decisions do not need additional recognition to be enforced.

The question of arbitrability of disputes is still under debate in Russia. The following disputes are generally regarded as not arbitrable:

- insolvency disputes;
- certain corporate disputes;
- disputes governed by Russian administrative law (eg with state authorities), including competition, tax, and privatisation disputes; and
- disputes related to Russian real estate which may affect registration entries in a real estate register.

- 42** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

We are not aware of such regulations or practice.

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