



# FRANCHISE *Watch*

INTERNATIONAL FRANCHISE DEVELOPMENT SERIES

October 31, 2018

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*This is the 20<sup>th</sup> article in Wiley Rein's International Franchise Development Series. The International Franchise Development Series offers a broad overview of franchise regulation and the legal issues confronting franchisors seeking to expand into certain countries from the combined legal perspective of U.S. and local counsel.*

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## Franchising in Russia: An Update

By Robert A. Smith, Dr. Natalya Babenkova, and Maureen A. O'Brien

*This Franchise Watch is an update to a Franchise Watch first issued on March 6, 2016.*

Franchising continues to be a very attractive commercial and contractual model in Russia. While pre-sale registration and disclosure of the franchise offering are not required in Russia, there are a number of facets of Russian law that a U.S.-based franchisor should consider before entering this market.

### Good Faith Requirement

Russian law requires that both parties act in good faith in pre-contractual negotiations. A party is deemed to lack good faith if it provides insufficient or untrue information or fails to disclose material facts. Unjustifiably terminating negotiations can also indicate a lack of good faith. A franchisor acting in bad faith can be held liable for damages, measured by the costs that the other party incurred in conducting the negotiations and the cost of lost alternative business opportunities. Accordingly, before beginning negotiations, a franchisor should consider entering into an agreement with a potential franchisee specifying and limiting the franchisor's disclosure obligations, limiting the franchisor's liability for damages (to the extent legally permissible), imposing non-disclosure obligations on both parties and acknowledging the franchisor's ownership of the intellectual property.

### Mandatory Russian Law

While a non-Russian franchisor can specify the law of another country as governing the overall agreement with a Russian franchisee, there are several mandatory provisions of Russian law that must be reflected in the agreement to comport with Russian public policy. First, a franchise agreement and any related documents (such as a guarantee) must be signed by both parties. Second, a franchise agreement must include not only a trademark license, but also an option to use at least one other intellectual property right, such as a patent, a trade secret, copyrighted material, or a trade name. Third, the trademark to be licensed must be registered in Russia at the time the franchise agreement takes effect. Fourth, each franchise agreement must include specific provisions regarding payment by the franchisee, since unlike the situation for private individuals, gifts between legal entities are not permitted. Accordingly, Russian counsel should review the proposed franchise agreement to ensure that it does not run afoul of mandatory public policy considerations.

### Rospatent Registration

Until recently, a franchisor was required to register the entire franchise agreement with

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the Russian Federal Service for Intellectual Property (Rospatent). Russian law no longer requires that the franchise agreement be registered; only the trademark license that is granted under the franchise agreement need be registered, otherwise, the trademark license does not become effective and will be void against any third party that later, in good faith, acquires a conflicting interest in the licensed mark.

For purposes of registering the trademark license, a simple notification can be submitted to Rospatent. The notification must include the names of the parties, the registration numbers of the trademarks in question, a description of the goods and services for which the trademark rights are granted, whether the license is exclusive or non-exclusive and its term, a description of the territory, the right to sublicense, if any, and the right to terminate the agreement by each party, if any. Since both parties must sign the notification, the standard practice is to use a dual-language format.

The registration process can be costly (since the amount of the Rospatent fees are based on the number of registered trademarks to be licensed), and it is time consuming.

Because there is no specific registration deadline, if the franchisee commences operations and begins paying royalties without first registering the license, the registration can be effected later and made retroactively effective. Waiting, however, can result in payment problems since Russian banks are required to review the legality of international transfer payments, such as franchise fee payments, and some banks, out of an abundance of caution, may refuse to process the payments to the franchisor if

the notification has not been registered. This can be headed off if the franchisee informs its bank in advance of the details of the franchise agreement and gets confirmation that the bank will process payments before the notification has been registered.

A notification must be filed for each franchised unit (or more precisely, for each franchise agreement), which means that the parties will have to incur the cost and delay with each new franchised outlet. It is possible, however, to avoid filing the notification for each unit if the parties enter into an agreement that covers multiple units, has a term that would cover the anticipated operating term of all units and provides a broad territory where the units may be located. With this approach, the franchisor is technically granting a general license to operate franchised units for a very long period of time and for a large territory, but the parties would contractually limit the actual operation of each unit to a particular location and for a specified term.

### **Franchisor Liability**

To protect consumers, Russian law subjects franchisors to liability under some circumstances. A franchisor and franchisee are jointly and severally liable for defective products manufactured by the franchisee. The franchisor is also secondarily liable for claims made against the franchisee with respect to the products sold or services rendered by the franchisee. Although the exposure to this liability may be a deterrent to foreign companies considering franchise operations in Russia, in practice, it has had little actual impact. To date, there have been few cases in which a Russian court has held a franchisor liable for a product or service

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sold by a franchisee. An indemnity running from the franchisee to the franchisor can limit the franchisor's potential exposure.

### **Right of First Refusal to Renew**

Upon expiration of a franchise agreement, unless in default, a franchisee has a right of first refusal to renew the agreement for a new term, but only if the renewal is on the same terms as the expired agreement. If the franchisor refuses to extend the agreement for a new term and instead enters into a franchise agreement with another person (within a year after expiration of the other agreement) that grants the same rights on the same terms as those granted to the franchisee under the prior agreement, the original franchisee can seek a court order to transfer the rights and obligations under the new agreement to it and/or seek compensation for losses caused by the refusal to renew the franchise agreement.

A franchisor can avoid this by substantively modifying the terms of the agreement offered to a new franchisee.

### **Dispute Resolution**

Since Russia and the U.S. are signatories to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, a non-Russian franchisor can require disputes to be submitted to arbitration before one of the major international tribunals, and Russian courts consistently enforce international arbitral awards. Without such an arbitration provision, the franchisor will have to resolve

any legal disputes by litigating in Russian courts, or – if the franchise agreement so specifies in its forum selection clause – in American courts. If the franchisor attempts to enforce an American court judgment in Russia, enforcement will have to be sought based on reciprocity and international comity since no treaty regarding the enforcement of foreign judgments is in effect between the United States and Russia. ■

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