



Franchise

in 30 jurisdictions worldwide

2014

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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 are the limited liability company (LLC) and the joint-stock company (JSC). Generally all forms of commercial legal entities and individual entrepreneurs can act as franchisors under Russian law, which means that forms of legal entities such as general partnerships, limited partnerships, unitary enterprises (a form of legal entity specific to Russia) and production cooperatives are allowed to be franchisors in Russia.

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

The formation of business entities is governed by the Russian Civil Code (RCC), Part I of 2001 and the Federal Law of 2001 on State Registration of Legal Entities and Individual Entrepreneurs. LLCs and JSCs are also regulated by special laws: the Federal Law of 1998 on Limited Liability Companies (LLC Law) and the Federal Law of 1995 on Joint Stock Companies (JSC Law). The Internal Revenue Code of the Russian Federation (IRC), Part II of 2000 stipulates the size of state duty collected for the registration of legal entities and individual entrepreneurs, and this is then processed by the local offices of the Federal Revenue Service.

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

It is necessary for a business entity to be registered by the local office of the Federal Revenue Service. The Federal Law on State Registration of Legal Entities and Individual Entrepreneurs states that the following documents should be provided for the registration of a business entity:

- an application registration form signed by a founder or founders of the legal entity (authenticity of the applicant's signature should be verified by a notary);
- a decision of founders on formation of the legal entity in the form of a record, agreement or other document according to Russian legislation;
- two copies of incorporating documents (a charter or an agreement of incorporation, or both);
- if one of the founders is a foreign business entity, an extract from the register of foreign business entities of the certain country (or another document comparable to this); and
- a document proving payment of the registration fee (state duty).

During registration, only formal examination of the provided documents (except for the application registration form) is carried out, which means that their content is not reviewed. But it should be noted that the name of a business entity should conform to a number of requirements, otherwise registration will be rejected. For

example, it should not include the name of the Russian Federation or of its official bodies without special permission.

After registration with the Federal Revenue Service, which usually takes up to five working days from the date of filing the required documents, the newly established legal entity has to be registered with the mandatory social funds (with the Pension Fund of the Russian Federation 10 days after registration at the Federal Revenue Service, and with the Social Insurance Fund of the Russian Federation 10 days after the first employment within the legal entity). It is also necessary to obtain the company seal (stamp) and to open a permanent bank account in Russia before starting business operations.

Maintaining a business requires the avoidance of situations that can be grounds for involuntary liquidation. According to the RCC a business entity can be liquidated by court decision among other things if:

- it was formed with serious law violations;
- its activity seriously violates law provisions;
- it does not have a licence for the specific activity it carries out;
- it carries out a prohibited activity; and
- its bankruptcy is proven by a court decision.

Many requirements depend on the form of business entity. Some have restrictions concerning the number of participants (for example, closed JSCs and LLCs cannot consist of more than 50 members). There are also provisions concerning the minimum charter capital that should be maintained, which is 10,000 roubles for the LLCs and 100,000 roubles for the JSCs.

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

According to the Federal Law of 2008 on Procedures for Foreign Investments in the Business Entities of Strategic Importance for Russian National Defence and State Security, foreign investors are restricted from entering into deals leading to control of Russian companies (LLCs, JSCs or additional liability companies) that are of strategic importance for the safety and defensive capacity of the Russian Federation. Such deals can be made only with the permission of the Federal Antimonopoly Service of the Russian Federation. Forty-two types of business activity are among those that are considered of strategic importance for the state defence and safety of Russia under this federal law. Among them are nuclear energy production, war weapons production and trade, activity connected with space and aviation technology.

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

There are no special tax requirements for franchise businesses in Russia, so the general tax system is applicable.

Franchisors in the form of legal entities are subject to corporate tax on a net income, which generally amounts to 20 per cent of their profit (revenue minus spending).

Individual entrepreneurs (natural persons, whether foreign or Russian, that are not registered as individual entrepreneurs cannot be participants in franchise relations in Russia) are subject to personal income tax, which generally amounts to 13 per cent of their income.

With a number of restrictions, individual entrepreneurs and relatively small legal entities can be relieved from the obligation to pay the personal income tax or the corporate tax on a net income, respectively, when they decide to use the simplified taxation scheme under which they pay a tax in the amount of six per cent of their income or 15 per cent from the income lessened on the amount of expenses.

Foreign franchisors are subject to the same taxes as Russian ones, but international double tax agreements between the Russian Federation and foreign states can reduce taxes for foreign franchisors or completely relieve them of such an obligation.

- 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?

It is a low risk that a franchisee or its employees could be deemed employees of the franchisor, as one of the obligatory requirements of the RCC is that a franchisee makes it clear to customers that it is acting under the licence of the franchisor.

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

Trademarks and know-how are protected by the RCC and a number of international agreements that Russia is a party to, including the Paris Convention for the Protection of Industrial Property, the Madrid Agreement on the International Registration of Trademarks and the Protocol to the Madrid Agreement.

A trademark needs to be registered at the Federal Service for Intellectual Property (Rospatent), and after that it comes under state protection. Liability for trademark violation is set out in the RCC, which stipulates that goods, labels and packages that unlawfully use a trademark are considered pirate. A franchisor (or another copyright holder) whose trademark is violated may claim for destruction of the pirate goods and claim compensation for damages suffered from the offence.

Know-how does not require registration and is protected by law from the moment of its creation. Know-how is protected as long as it is kept secret, which is possible if certain measures are taken. In particular, it is necessary to introduce the commercial secret regime (stipulated by the Federal Law of 2004 on Trade Secrets). Liability for know-how violation is set out in the RCC, which states that the offender must compensate all the damages caused to the franchisor (or another copyright holder).

A trademark or know-how violation can also be qualified as an act of unfair competition, which is prohibited according to the Federal Law of 2006 on Competition Protection and the Paris Convention for the Protection of Industrial Property. Officials and legal entities are punished for unfair competition by the government under the Administrative Offence Code of the Russian Federation of 2001.

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

Information about all real property, including details about its owners, their rights and certain titles to the property is kept in a special register. Deals concerning purchase of real estate should also be registered to be considered concluded and effective.

According to the Land Code of the Russian Federation of 2001, land in Russia can be the property of private persons, municipal

bodies or of the state itself. Land can be purchased from private owners, privatised (municipal or state property) or leased on certain conditions agreed between the parties or stipulated in official documents. It should be noted that foreign individuals and foreign legal entities are restricted in the purchase of certain types of land; in particular this rule concerns border territory, agricultural land and seaport territory.

_____ Laws and agencies that regulate the offer and sale of franchises

- 9** What is the legal definition of a franchise?

Russian law does not define the term 'franchise'. Under the RCC, 'agreement of the commercial concession' (the term used to describe a franchise agreement) is an agreement under which a franchisor ('a copyright holder' under the RCC) must allow a franchisee ('a user' under the RCC), with or without indication of the specific time period, to use the franchisor's intellectual property (including trademark, service mark, trade name, know-how, etc) in its commercial activity. A franchisee must pay for the use of franchisor's intellectual property.

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

The offer and sale of franchises are regulated by the RCC. There are no governmental agencies that specifically regulate the offer and sale of franchises, but franchise agreements are to be registered at Rospatent, otherwise they would be considered null.

- 11** Describe the relevant requirements of these laws and agencies.

The RCC provides that franchise agreements can only be entered into by commercial entities and individual entrepreneurs. A franchise agreement needs to be made in writing and registered at Rospatent. It is always a non-gratuitous agreement, and its price or the way of its evaluation should be expressly stated in its text. Trademarks and other intellectual property that is provided to a franchisee should be clearly defined. Where any of these requirements are not met, the franchise agreement would be null.

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

There are no such exemptions or exclusions.

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

There are no such requirements.

- 14** Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

There are no such restrictions.

- 15** 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?

Russian law does not contain any requirements concerning disclosure procedures. In the case of a sub-franchise structure, the procedure of disclosure should be agreed between the franchisor and the franchisee.

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

There are no requirements concerning disclosure procedures in connection with franchise agreements in Russian law.

17 What information must the disclosure document contain?

This question is not relevant for Russia as there are no requirements for disclosure.

18 Is there any obligation for continuing disclosure?

This question is not relevant for Russia as there are no requirements for disclosure.

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

This question is not relevant for Russia as there are no requirements for disclosure.

20 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?

This question is not relevant for Russia as there are no requirements for disclosure.

21 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?

This question is not relevant for Russia as there are no requirements for disclosure.

22 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?

Offer and sale of franchises are governed by the general principles of the RCC, which are as follows:

- participants of civil law transactions are considered equal;
- property is indefeasible;
- extralegal interference into private affairs is prohibited;
- civil rights should be exercised in an unhampered way;
- violated rights should be restored and protected by the court;
- individuals and legal entities act voluntarily and in their own interest. They are free to enter into agreements that do not violate law regulations;
- civil rights can be limited only by the federal law and only for the sake of protecting the constitutional system, morality, health, rights and lawful interests of other persons, securing the defence and safety of the state;
- participants of the civil law relations should act in good faith;
- no one may acquire advantages from illegal or unfair activity; and
- goods, services and financial instruments move freely within the territory of the Russian Federation.

23 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

There are no requirements for any sort of disclosure that a franchisor or a franchisee should go through.

24 What 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?

If a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises and this fact is proven in court, the franchise agreement will be considered null as an agreement that resulted from one party's deception, which means that the franchisee may retrieve everything that was transferred to the franchisor and to claim for compensation of all the real damages suffered as a result of the franchisor's fraudulent or deceptive actions.

The question about franchise sales disclosure laws is not relevant.

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

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

The relationship between a franchisor and a franchisee is regulated by the RCC notwithstanding the status of their agreement (whether it is effective or not).

26 Do other laws affect the franchise relationship?

The franchise relationship can be affected by the Federal Law of 2006 on Competition Protection, which contains certain restrictions for the sake of competition protection. For example, it can limit the franchisee's powers to oblige the franchisor not to provide the same franchise to third parties in case it would harm the competition.

27 Do other government or trade association policies affect the franchise relationship?

As mentioned in the previous paragraph, a franchise relationship can be affected by competition protection law and the policy of the Federal Antimonopoly Service, which defines the implementation of the competition protection law. Besides this, the Russian Franchise Organisation (a non-profit public organisation) may influence the franchise business in some respect.

28 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?

According to the RCC, a franchisor may terminate a franchise agreement of unlimited duration at any time, giving the franchisee notice of termination six months in advance unless their agreement provides for a longer notification period. A franchise agreement with a specified duration can be terminated in cases where it is stipulated in the agreement, and in the case of substantial violations of the agreement by a franchisee. A franchisor can also claim for termination of the franchise agreement where there have been substantial changes in the circumstances that parties based on when entering into the agreement.

29 In what circumstances may a franchisee terminate a franchise relationship?

A franchisee can terminate the franchise agreement on the same grounds as a franchisor.

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

A franchisor may refuse to renew the franchise agreement with a franchisee if the franchisee did not duly adhere to the franchise agreement provisions. Where a franchisee duly performed its obligations under the expiring agreement, a franchisor is prohibited from entering into the same franchise agreement on the same conditions with a third party for one year after the expiration of the original franchise agreement. If the franchisor unlawfully refuses the franchisee's right to renew the contract and enters into it with the third party, the franchisee may seek to transfer the third party's rights to itself and for compensation of damages suffered, or only for the compensation of the damages.

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

Under the RCC a franchisee may transfer its franchise to a third party only with the agreement of a franchisor. At the same time a franchisor cannot restrict transfers of ownership interests in a franchisee entity; such provisions of the franchise agreement would be considered null as provisions restricting capability.

32 Are there laws or regulations affecting the nature, amount or payment of fees?

There are no such laws or regulations, but the amount of fee or the order of its evaluation is a compulsory condition of a franchise agreement that should be agreed upon between the parties and included in the agreement, otherwise it would be considered null.

33 Are there restrictions on the amount of interest that can be charged on overdue payments?

There are no such restrictions, but the RCC provides that a franchisee can claim for the reduction of the penalty fee amount on the grounds of its excessiveness in comparison to the damages suffered by a franchisor as a result of an overdue payment.

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

No, there are no such restrictions. Transactions between residents and non-residents of the Russian Federation can be carried out without any limitation according to the Federal Law of 2003 on Currency Regulation and Currency Control.

35 Are confidentiality covenants in franchise agreements enforceable?

Yes, they are. A franchisee must not disclose know-how and other confidential commercial information of a franchisor under the RCC, but at the same time a franchisee must make it clear to the customers that it is acting under the licence of the franchisor.

36 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 expressly named in the RCC as one of the general principles of Russian Civil Law. However, the way it affects franchise relationships is difficult to assess at the moment as this principle was introduced into the RCC less than one year ago and there is no established court practice in this area.

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

No. According to the Federal Law of 1992 on Consumers' Rights Protection, only individuals entering into deals of private interest, not connected with the business activity, can be viewed as consumers.

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

There are no restrictions regarding the language of agreements entered by parties on the territory of the Russian Federation, but where the franchise agreement is not in the Russian language its notarised translation will be necessary for the registration at Rospatent as the Russian language is an official language of the Russian Federation and must be used by its governmental bodies under the Federal Law of 2005 on Official Language of the Russian Federation.

39 What restrictions are there on provisions in franchise contracts?

According to the RCC, a franchisor may not determine the price of the goods sold or services provided by a franchisee or determine the specific category of the consumers for a franchisor.

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

The Competition Protection Law prohibits abuse of market dominance, which means that a franchisor's obligation not to provide the same franchise to the third parties, or not to compete with a franchisee on the same territory, or a franchisee's obligation not to obtain franchises in the same business sphere from the franchisor's competitors can be considered null where they constitute an abuse of market dominance.

A violation of the antimonopoly regulations is an administrative offence under the Administrative Offence Code of Russia, punishment for which is enforced by the Federal Antimonopoly Service. Non-observance of Federal Antimonopoly Service decisions is also an administrative offence.

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

The Russian state court system consists of:

- the Federal Constitutional Court;
- the constitutional courts of the subjects of the Russian Federation;
- the state civil courts system; and
- the state commercial courts system.

Constitutional courts deal with the compatibility of provisions of the law and regulations with the Constitution of the Russian Federation and the constitutions of the federation subjects. State civil courts resolve civil disputes and hear criminal cases. Commercial state courts resolve disputes connected with commercial activity between business entities and individual entrepreneurs.

Update and trends

The Draft Federal Law on Changes to parts I, II, III and IV of the Russian Civil Code and Certain Legislative Acts of the Russian Federation (adopted by the State Duma of the Russian Federation in the spring of 2012) proposes a number of changes regarding franchise relationships.

First of all, this Draft specifies the law applicable to franchise relationships where it has not been agreed between the parties. The Draft proposes that a franchise agreement should be governed by the law of the state where a franchisee has the right to use a franchise. Where there are more than one such states it should be governed by the law of the state where a franchisor has its residence or primarily runs the business.

Absence of state registration of a franchise agreement would not

lead to its nullity but would mean that the franchise was not provided for a franchisee.

The Draft also proposes that a copyright holder can provide the general public with the right to use its intellectual property freely on certain conditions and for a certain period of time. However, a copyright holder should be deprived of such a possibility in case there is an active commercial licence on the same rights. Provisions concerning the licence agreement are applicable to franchise relationships according to the RCC.

It should also be mentioned that practising lawyers and scientists suggest that a unified database of franchises should be created and governed by the professionals that would verify and update its content.

Parties to a franchise agreement can resolve their disputes in the state commercial courts, in arbitration or using mediation procedures. Court decisions can be appealed in three instances while arbitral awards are irrevocable, although it is still possible to try to set them aside or to claim for refusing recognition and enforcement of the arbitral awards. Mediation results in a mediation agreement, which is a kind of civil contract and cannot be enforced through the state authorities.

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

Probably the main advantage of arbitration over the state court procedure is the opportunity to choose arbitrators who are well aware of the cross-border deals regulation or of the foreign law applicable to the contract in dispute. State court judges are not always experienced in this sphere. Besides this, the state court procedure can be more time-consuming than the arbitration one, especially when the dispute goes through all the appeal stages in the state court.

Generally, Russian legislation in regard to international arbitration does not differ from internationally recognised standards.

Russia is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the Law of the Russian Federation of 1993 on International Commercial Arbitration is based on the UNCITRAL Model Law of 1985. It means that regulation of international arbitration in Russia does not have specific peculiarities. But it should be remembered that arbitral awards that contradict public policy of the Russian Federation would not be enforced by the Russian courts, and in this respect Russian public policy is the main peculiarity of arbitration process where enforcement of the arbitral award takes place in Russia.

It can also be noticed that dispute resolution in Russian arbitration institutions is comparatively cheap; for instance it is much cheaper than arbitration in the United Kingdom or United States.

43 In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

According to the RCC, foreign legal entities and foreign individuals are treated in the same way unless there are exceptions set by the federal laws of the Russian Federation. At the moment there are no exceptions concerning foreign franchisors in Russian legislation.



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