

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Franchising Under the New Civil and Economic Codes

I. Introduction

Ukraine has not been traditionally known for its accessibility for franchising. In fact, Ukraine has always adhered to the notion that franchising is nothing more than a series of separate agreements between two parties. Therefore, in the past, franchising involved the conclusion of various agreements, each of which should have been drafted in accordance with the different laws to which they relate. However, when the Civil and Economic Codes came into force in 2004, a new concept was introduced into Ukrainian law known as “commercial concessions.” While commercial concessions are not explicitly titled “franchising”, an analysis of both the Civil and Economic Codes of Ukraine reveals that franchising will become an even more viable option for foreign investors in Ukraine in the near future. In our discussion below, we indicate where one of the Codes provides provisions additional to those contained in the other Code.

II. Discussion

According to the Civil Code (No. 435-IV, dated January 16, 2003, effective January 1, 2004) and the Economic Code (No. 436-IV, dated January 16, 2003, effective January 1, 2004), parties interested in implementing a franchising arrangement on the territory of Ukraine may conclude so-called “agreements on commercial concession”. Under an agreement on commercial concession, one party (a right holder) grants to another party (a right user) *on a payment basis* the right to use a complex of rights belonging to the right holder for the production and/or sale of a certain type of product and/or the provision of services. While both Codes imply that the granting of such use rights will be regulated by the Codes and other laws, no other specific laws have been passed with respect to commercial concessions.

In a nutshell, the subject of an agreement on concession is the right to use objects of intellectual property (trademarks, industrial designs, inventions, works, commercial secrets, etc.) and the commercial experience and business reputation of the right holder on a payment basis. The Commercial Code provides that remuneration under an agreement on commercial concession may be paid as a one-time payment, periodical payments or in any other form provided by the agreement. An agreement on commercial concession may contain provisions regarding a specific territory of use of the rights; however, this is not a mandatory provision of such agreements.

Both natural persons and legal entities may be parties to an agreement on commercial concession provided that they are so-called “subjects of entrepreneurial activity” (i.e., they carry out business for a commercial purpose). The form of an agreement on commercial concession is quite simple: it must be in writing and is subject to state registration. A failure to comply with the requirement that such agreements must be in writing will lead to their invalidity. The Commercial Code further provides that an agreement on commercial concession must be concluded “in the form of one document”. Thus, the classic franchising agreement may be tweaked to comply with the requirements of an agreement on commercial concession.

At present, the Ukrainian business community awaits the necessary legislative acts and instructions, which will allow for the state registration of such agreements. In any case, the registration of agreements on commercial concession must be carried out by the body, which carried out the state registration of the right holder. If the right holder was registered in another country, then the body, which carried out the state registration of the right user, will be responsible for the state registration of the agreement on commercial concession. In all relations with third parties, the parties to an agreement on commercial concession may not refer to such agreement until the complete state registration of the agreement. The Economic Code adds that the absence of the state registration of an agreement on commercial concession will remove the parties’ right to refer to the agreement in case any disputes arise.

Both the Civil and Economic Codes also provide for commercial sub-concessions in cases provided by an agreement on commercial concession or otherwise agreed upon by the right holder. If an agreement on commercial concession (or other arrangement with a right holder) permits the user to conclude an agreement on commercial sub-concession, then the user may provide another party (a sub-user of rights) with the right to use the complex of rights or a part thereof granted to it by the right holder. Unless a commercial sub-concession arrangement is separately agreed upon by the parties, the agreement on commercial concession, which grants the right of commercial sub-concession to the original user, must be attached to the agreement on commercial sub-concession. Under commercial sub-concessions, the user and the sub-user are jointly liable to the right holder for any damages incurred thereby. In case an agreement on commercial concession is deemed invalid for any legitimate reason, an agreement on commercial sub-concession in connection with such invalidated agreement will also be deemed invalid.

In general, pursuant to commercial concession agreements, the right holder must transfer to the user of rights all of the technical and commercial documentation and/or other information necessary for exercising the granted complex of rights. The right holder must additionally inform the user and its employees regarding all issues connected with the exercise of such rights. Further, the right holder is responsible for the state registration of the agreement on commercial concession (unless he/she/it is registered in another state), providing the user with a constant flow of technical and consulting assistance in the training and increase of qualifications of employees, and controlling the quality of

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