

# Modern Franchising in Ukraine

DR. ANNA  
TSIRAT



Partner, Jurvneshservice, a member of International Bar Association, Kyiv Region Bar, Center for International Legal Studies (Salzburg, Austria)

Dr. Tsirat is known as an expert in the field of aircraft financing and author to chapters on Ukraine in The Official Guide to Aircraft Registration and Tax, World Aircraft Repossession Index, Aircraft Liens and Detention Rights and Aircraft Financing both under gen. ed. G. McBain, chapters on Air Transport and Aviation Finance & Leasing in The Getting the Deal Through, The Aviation Law Review under gen. ed Sean Gates, etc

While franchising was just a fashionable word in Ukraine in the late 1990's, today it is used by Ukrainian entrepreneurs to promote their business throughout the nation and the world. Popular entrepreneurial areas of franchising in Ukraine include food, clothing, linen, footwear, entertainment and transport. At the same time, I would not say that the term franchising is used as widely in Ukraine as it is in USA or Europe. There are objective and subjective reasons.

I regard the following as objective reasons:

- Shortage of experts in certain types of business activity that could skillfully apply this method of product marketing with profit for the franchisor;
- Lack of knowledge about franchising as a marketing method and technology of its use;
- The franchising agreement is still a novelty for most lawyers while a draft agreement needs special knowledge about

the peculiarities of the rights and liabilities of parties since the franchising agreement is a complex one in comparison with other types of contracts;

— *Civil and Commercial Codes of Ukraine* (the Codes) regulate commercial concession agreements that are very similar to franchising ones in some aspects;

— The lack of wide jurisprudence on settlement of disputes out of franchising agreements, on the one hand, and strange conclusions adopted by courts in some judgments (for example, some courts mistakenly regarded commercial concession agreements as a concession agreement regulated by Law of Ukraine No. 997-XIV of 16.07.1999 *On Concessions*).

Subjective reasons for not using franchising include:

— Reluctance of potential franchisors to train potential franchisees in certain entrepreneurial skills, since such franchisees are considered as potential competitors;

— Uncertainty of potential franchisors about the possibility to defend their intellectual property rights used in franchising. This uncertainty is based on -

— absence of jurisprudence as to disputes arising from franchising agreements. Available court judgments prove that a franchisor usually fails to protect its rights in court;

— absence of a sufficient number of judges in total and commercial courts who really understand the peculiarities of franchise agreements and protection of intellectual property rights, and the failure to launch the work of High Intellectual Property Rights Court (HIPRC) at the prescribed time. There were many expectations connected with HIPRC, but due to long preparations for its launch these expectations have turned into disappointment;

— problems within enforcement of judgments on protection of intellectual property rights;

— The reluctance of potential franchisees to invest significant funds in their own business to create a franchise unit similar to the franchisor's one as the population's purchasing power is very low;

— Lack of information on available experts who could help a potential franchisor in creation and developing individual elements of the franchise (designers, psychologists, lawyers, economists, etc.).

It's clear that the subjective reasons for limited use of franchising will be overcome

with time once local potential franchisors ensure that the benefits of franchising outweigh the risks of its use. Besides, franchising today is changing from its 'vanilla' forms (unit franchising, master franchising and development agreements), which are now treated as unsuitable for international expansion to sophisticated hybrid structures such as subordinated equity agreements and 'extra-franchise' structures like various management agreements: 'manchising' and 'francubating'.

As Ukrainian legislation does not distinguish such agreements as franchising, we will compare commercial concession and various forms of franchising agreements. Commercial concession agreements are regulated by the *Civil* (Chapter 76) and *Commercial* (Chapter 36) *Codes of Ukraine*. Since under commercial concession agreements the objects of intellectual property rights are granted, the legal relations of the franchisor and franchisee are regulated by Chapters 35, 36, 38-44 of the *Civil Code of Ukraine* (the CCU) and special laws on protection of intellectual property rights. Besides, commercial concession agreements are governed by the competition law of Ukraine if a franchisor's or franchisee's share exceeds 30% on the relevant market. We may agree with Mark Abell, editor of *The Franchise Law Review*, that a heterogeneous approach to the regulation of franchising and complex interplay of more general legal concepts such as antitrust law, intellectual property rights and the doctrine of good faith presents a barrier to the use of franchising as a catalyst for national and international growth.

The basic franchising agreement is intended for the operation of a single-unit. Having drawn an analogy, we can say that a commercial concession agreement under the Codes corresponds to this type of franchise agreement.

According to the Codes the parties to commercial concession agreements are entrepreneurs, one of whom is the rightholder and the other the user. The latter acquires from the rightholder objects of intellectual property rights (trademarks, industrial designs, inventions, computer programs, manuals, etc.), specified as a "set of rights" for the production and/or sale of goods and services. The concept of "set of rights" is analogous to the concept of "franchise". Although the Codes indicate that the rightholder among the other components of the "set of rights" provides the user with a business reputation,

## JURVNESHSERVICE

**J**urvneservice was formed in 1987 and since then has been advising leading Ukrainian and foreign corporations on legal issues of the contemporary Ukrainian market. Jurvneshservice's attorneys have cultivated the culture, commercial pragmatism and technical and interpersonal skills required to deliver world-class services tailored for the preferences of world-class clients. Over the years of practice the firm's attorneys have received numerous awards and written a great number of publications.

Jurvneservice cooperates with such leading law publishers as Kluwer Law International, which issued the Anna and Gennadii Tsirats monograph *Civil Procedure in Ukraine* (2012) and *Intellectual Property Law in Ukraine* (2011). Gennadii Tsirat is an expert in cross-border litigation and has published monographs *International Civil Process: Modern Condition and Perspectives of Interna-*

*tional Unification* (2013), *International Commercial Arbitration* (2002) and *International Arbitration as a Means of Disputes Settlement* (1997).

As the leading expert on franchising in Ukraine, Anna Tsirat has published the *Guide on Drafting of Franchise Agreements* (2010) as well as *Franchise and Franchising Agreement* (2002). Her studies in aircraft finance are reflected in the monograph *International Private Air Law* (2018). Anna Tsirat is the author of numerous chapters on Ukraine that are updated annually. These include *The Official Guide to Aircraft Registration and Tax*, *PWSP World Aircraft Repossession Index*, *Aircraft Financing*, *Aircraft Liens and Detention Rights*, *International Agency and Distribution Law*, *Getting the Deal Through: Air Transport*, *Getting the Deal Through: Franchise in 28 jurisdictions worldwide*, *Getting the Deal Through: License in 28 jurisdictions world-*

*wide*, *The Aviation Law Review*, *International Joint Ventures*, *International Secured Transactions*, *International Franchising*, etc.

Jurvneservice attorneys work as one team with clients, other law firms, advisers and one another. This approach enables the needs of clients to be addressed more efficiently. Clients retain Jurvneshservice because its attorneys understand their businesses and are committed to finding practical ways to help them to grow and succeed.

The main practice areas of Jurvneshservice are aircraft finance, anti-corruption, bankruptcy, corporate disputes, criminal law, cross-border litigation and debt recovery, enforcement of foreign arbitral awards and judgments, intellectual property including franchising protection, international arbitration, project finance, white collar crime, unfair competition.

it may not be conveyed. According to Article 202 of the CCU, a business reputation is an object of subjective civil rights that belongs to the category of personal non-proprietary rights of an individual. However, legal entities may also have a business reputation that will be treated as the non-property rights of such a legal entity. Subjective non-proprietary rights are inalienable and, therefore, may not be passed on to anyone else. Thus, the rightholder does not take any action to provide a business reputation. In practice, a consumer associates a franchisee's unit with the rightholder's unit and, in this manner, the user finds himself/herself under the umbrella of the rightholder's business reputation, and so this gives the franchisee the opportunity to conduct profitable activities from the first days of its operation.

Another type of franchise agreement is a multiple/multi-unit franchise. The Codes do not regulate a similar type of agreement, but it can be used in Ukraine with the application of the same legislative acts as it does to commercial concession agreements. At the heart of single unit and multi-unit franchising agreements is a non-exclusive franchise, which implies the right of the franchisor to independently use the franchise in the same area as the franchisee, and transfer it to another franchisee. Providing a franchisee with an exclusive franchise assumes a ban on the franchisor to independently use or transfer a franchise to another franchisee in the same locality.

An exclusive franchise is the subject of development, master area development and master franchise agreements. In order to ful-

fill these types of agreements, the franchisee has the right to conclude sub-agreements that are single unit or multi-unit franchising agreements. The possibility for the user to conclude sub-agreements (commercial sub-concession agreements) is provided by the Codes. But it is quite difficult to make an analogy between commercial concession agreements and development, master area development and master franchise agreements. Development agreements, in our opinion, do not relate to purely franchising, but are framework agreements, the implementation of which is carried out through the appropriate type of franchise agreement.

In general, I would note that Ukrainian franchisors often conclude agreements of commercial concession rather than franchise agreements, since they believe that concluding agreements of commercial concession will contribute to better protection of their rights in a court. If the franchisor is a foreign entrepreneur under the agreement, the franchising agreement will be concluded as it is most applicable in international practice.

Hybrid structures are used if there is a lack of potential developers or master franchisees or stiff competition from other franchisors for developers and master franchisees. At the same time, hybrid structures give parties flexibility and transparency on a jointly-owned business, faster route to scalability, enabling the carrying out of greater control, providing exit options to the brandowner and improved profitability.

A Manchise agreement is a hybrid of a franchise agreement and a management contract and is used in the hotel industry. This

type of arrangement is appropriate where the local partner is primarily an investor rather than an operator. This form of contract provides for greater involvement of the hotel owner, who attracts an international hotel operator for entire management and control of the hotel for an initial period that does not normally exceed 5 years. Manchise agreements can be bilateral or trilateral if day-to-day hotel operations are carried out by a non-branded management company. This type of agreement already exists in Ukraine.

The owners of a given trade mark come back after an operator runs a hotel for the first initial years. Manchising helps brands to grow faster. In a management model, the entire responsibility for the hotel's balance sheet and financial performance is placed on the hotel brand, while the operator provides marketing support.

Another hybrid structure actively used in the Food & Beverage sector in the UK (but not in Ukraine) is francubation. It's a good device in a Ukrainian situation where banks are reluctant to lend to small businesses. Francubation enables success for both the franchisor and franchisee as it removes the 'artificial' fiscal barrier of access by capable prospective franchisees to funding. Under a francubation agreement that is a kind of 'buy-in' structure. The franchisor funds part of the set-up cost of the franchisee's new unit and allows the franchisee to buy the rest of the business in a series of tranches from the profits generated by this unit. This structure allows the franchisor to attract a mature franchisee who will "guarantee" the profitability of the new unit and the growth of the franchisor's network.