

“HEART AND SOUL” OF FRANCHISING,

or Intellectual Property Rights in Franchise Agreements

In view of continuing globalization, capturing new markets and expanding presence thereon recently became a top priority for all companies. Franchising is one of the possible options of such “expansion”. It is a convenient vehicle for both “capturing companies” and franchisees, as the former can ensure their widespread presence on the account of franchisees, while the latter become members of the well-established franchising family that significantly mitigate the risks of defaults.

It goes without saying that, in order to be strong enough to enable both franchisors and franchisees to succeed in their businesses, a franchising chain shall be founded and developed on the basis of a strong brand name/trademark known and clearly identified by the public as well as substantial amount of know-how, and be compared favorably with the business systems of competitors.

Our aim in this article is not to analyze in details the franchising relations as a whole, but to focus in the main on major issues as regards the granting of intellectual property rights objects (IP objects), which are their “heart and soul”. Even though usually franchise agreements concluded with a Ukrainian counterparty are subject to a foreign law, we will try to cover in the present article the issues related to the practical

enforceability and safe use of IP objects thereunder in Ukraine.

Subject matter of franchise agreements

Notably, under Ukrainian law and the law of various foreign countries (e.g. Italy, USA, Germany, UK, Canada¹) IP objects (e.g. trademarks, utility models, inventions, know-how, writings, etc.) make up the subject matter of a franchise agreement.

The crucial importance of IP objects (especially the well-established and clearly identified trademarks) for franchising is confirmed by several provisions of the *Civil Code of Ukraine* (Civil Code). Firstly, if the trademark or another designation granted to the franchisee under the franchise agreement is changed, the franchisee is entitled to request for franchise agreement termination and indemnification of damages caused or if such agreement remains in force, the franchisee may request a decrease of the relevant payments. Secondly, if rights of the franchisor to the trademark or another designation are terminated without replacement by

another trademark or designation, the franchise agreement shall be terminated. Hence, due use and protection of the IP objects within the franchising chain and from actions of third parties shall be a top priority for both franchisors and franchisees.

Issues of major concern

In order to conclude the mutually advantageous franchise agreement, the franchisors and the franchisees shall take into account plenty of different issues. However, the IP objects and related issues shall be negotiated with due consideration. We believe that parties to franchise agreements shall at least pay attention to the following issues to ensure smooth use and protection of IP objects in Ukraine.

IP objects to be granted under the franchise agreement

Quite often franchise agreements just indicate that the franchisee is granted with the rights to use trademarks, logos and other IP objects. Such unclear wording may potentially result in disputes between the franchisors and the franchisees in respect of the IP objects to be actually used and paid by the franchisee. To avoid any misunderstandings, it is crucial to stipulate in franchise agreements



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¹ IDI Project — Country report on franchising — Italy prepared by Fabio Bortolotti; IDI Project — Country report on franchising — U.S.A. prepared by Carl E. Zwisler; IDI Project — Country report on franchising — Germany prepared by Marco Hero; IDI Project — Country report on franchising — UK prepared by John Pratt; IDI Project — Country report on franchising — Canada prepared by Frank Zaid and James Blackburn // <http://www.idiproject.com>

Due USE and protection of the IP OBJECTS... shall be a TOP PRIORITY for both FRANCHISORS and FRANCHISEES

(or in separate annexes thereto) an exhaustive list of the IP objects granted, including details of the relevant certificates and patents for the IP objects conditional upon registration (e.g. trademarks, inventions, utility models, etc.). In addition, it is advisable that franchise agreements envisage exact terms and conditions of the allowed use for each IP object granted.

Status of IP objects

It is well-known that as a rule franchise agreements grant right to use IP objects conditional upon registration. Pursuant to the *Civil Code* rights to use the IP objects that are not valid as of the date of entering into the licensing agreement shall not be subject-matter thereof. Thus, only duly registered under the national or international procedure (if applicable) IP objects may be licensed. Hence, if the franchisor intends to expand either domestically or internationally, it is crucial to take care of due registration of all IP objects in the target countries.

The franchisee, in its turn, shall carefully verify the status of each IP object granted under the franchise agreement (i.e. due registration, etc.). For the IP objects registered in Ukraine, the franchisor shall provide an excerpt from the relevant Ukrainian registers of the particular IP objects or in case of international registration (if applicable) — an excerpt from the respective international registers and information of the Ministry of Education and Science of Ukraine on effectiveness of international registration in Ukraine.

Otherwise, there is a potential risk that the franchisee will be granted only with designation not regarded as an IP object under Ukrainian law and thus, being not subject to legal protection allowing either to franchisors or franchisees to prohibit third persons (usually direct competitors)

from using the same or very similar IP objects.

Sometimes franchisors try to convince a franchisee that they have already applied for registration of the IP objects with the relevant authorities. However, such assurances most probably will not fully protect the franchisee's rights as it may well be that the relevant authorities refuse to register IP objects and the franchisor will not be in a position to oppose such refusal.

Who is the owner of IP objects?

Frequently, especially in case of famous global franchising chains, there are several affiliated companies involved in franchise transactions. For example, franchisors responsible for concluding the franchise agreements and the due owners of the IP objects to be granted under the franchise agreements (usually franchisors and the owners are affiliated or otherwise related companies).

In the latter case, so as to avoid any possible risks (e.g. related to infringement of rights of the due owner of the IP objects, impossibility to carry out payments in foreign currency in favour of a person who is not a party to the franchise agreement, etc.), it goes without saying that the franchisee shall, first, identify the due owner of the IP objects² and, second, carefully verify the authorities of the franchisor to license the IP objects under the franchise agreement³.

Ways of using IP objects

According to the *Civil Code*, "the rights to use IP objects and ways of use thereof that are not

directly defined in a licensing agreement shall be regarded as not granted to a licensee".

It is noteworthy that the laws specifically regulating particular IP objects provide for a list of ways of using the respective objects. For example, the *On Protection of Rights to Trademarks for Goods and Services Act* envisages a wide range of ways to be regarded as trademark use: (a) trademark placement on a product, product package, signboard, labeling, tags as well as other objects placed on a product; storage of products with the trademark placed thereon for the purposes of offering the latter for sale; sale, import and export of products with the trademark placed thereon; (b) use of trademark, while offering and rendering any services; (b) application of trademark in commercial documents or advertising and on the Internet. The *On Protection of Rights to Utility Models Act* stipulates the following ways of using a utility model: production of goods with application of patented utility model, application of such products, offering the latter for sale incl. via the Internet, sale, import as well as other ways of introduction in commerce or storage of the said products for the indicated purposes. Hence, all relevant ways of use for each particular IP object shall be set out in the franchise agreement.

Validity of rights to IP objects

For the successful operation of the franchise, it is crucial for the franchisee that the licensed IP objects are still valid and efficiently protected during the entire term of the franchise agreement. For such purposes, it is advisable to stipulate in franchise agreements the following franchisor's obligations: (a) to maintain rights to the licensed IP objects (the latter is especially important for those IP objects, the rights to which shall

² For such purposes excerpts from the relevant national or international registers may be used.

³ For such purposes the relevant agreement, under which the due owner of the IP objects has authorized the franchisor to license rights to the IP objects or at least the letter of assurance executed by the franchisor and the owner of the IP objects shall be requested by the franchisee.

be renewed by paying the respective duties e.g. trademarks, utility models); (b) to preserve confidential information, commercial secret and know-how from disclosure to third parties; (c) to take the relevant actions in case of an infringement by a third party of rights to the IP objects. Moreover, for such purposes franchise agreements shall stipulate considerable penalties for infringement of the above obligations by the franchisors.

Franchise vs. licensing agreement

There are different options for granting rights to IP objects currently in use to franchisees, namely: either a franchise agreement containing the so-called "licensing clause" or a separate licensing agreement. To avoid any potential disputes, the parties shall clearly define in the franchise agreement whether the franchisee

is entitled to start using the IP objects under the franchise agreement or an additional licensing agreement shall be entered into. In the said case, it is crucial to stipulate in the franchise agreement when the said licensing agreement shall be concluded and agree upon all the essential terms and conditions thereof.

Registration of licensing agreement or licensing clause of franchise agreement

Neither the *Civil Code* nor the special laws specifically regulating particular IP objects in Ukraine require mandatory state registration of the licensing agreement. At the same time, the said registration may be performed at the request of either the licensor or licensee.

It is worth noting that from the practical standpoint, state registration may be beneficial for both parties, amongst

others, for protection of IP rights against any violations by third parties. In addition, from the procedural standpoint, state registration is a very flexible vehicle. For example, it may be performed at any moment after conclusion of the licensing agreement; only extracts thereof related to terms and conditions of license transfer may be submitted for registration purposes eliminating risks of disclosure of confidential information, etc. However, whilst deciding on registration, the parties shall also consider ownership issues in respect of the IP objects as well as business and corporate structure of the project.

It goes without saying that both franchisors and franchisees are interested in mutually advantageous franchise agreements and safe relations. Therefore, they shall jointly identify and overcome all hidden reefs in respect of applicable IP issues.

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