



ICLG

The International Comparative Legal Guide to:

Franchise 2018

4th Edition

A practical cross-border insight into franchise law

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General Chapters:

1	Franchising as a Means to Access New and More Lucrative Markets – Iain Bowler, DLA Piper	1
2	Five Key Difference Makers: Best Practices in Enhancing the Likelihood of Your International Franchise Success – Brian Schnell & Lucie Guyot, Faegre Baker Daniels	4
3	Mergers & Acquisitions Involving Franchise Systems: Key Due Diligence Considerations – Joyce Mazero & Sarah Walters, Gardere Wynne Sewell LLP	9

Country Question and Answer Chapters:

4	Australia	Marsh & Maher Lawyers: Robert Toth	16
5	Austria	Rechtsanwaltskanzlei Dr. Amelie Pohl: Dr. Amelie Pohl	24
6	Belgium	FLINN: Benoit Simpelaere & Leonard Hawkes	30
7	Brazil	Daniel Legal & IP Strategy: Hannah Vitória M. Fernandes & André Ferreira de Oliveira	38
8	Canada	Dickinson Wright LLP: Edward (Ned) Levitt & Andrae J. Marrocco	46
9	China	Jones & Co.: Paul Jones & Xin (Leo) Xu	55
10	Denmark	Horten Advokatpartnerselskab: Peter E. P. Gregersen	63
11	England & Wales	DLA Piper: Iain Bowler	69
12	Germany	Hoffmann Liebs Fritsch & Partner Rechtsanwälte mbB: Christoph Schmitt	79
13	India	Kanga & Co: Preeti Mehta & Chetan Thakkar	86
14	Iran	Persia Associates: Dr. Alireza Azimzadeh	94
15	Japan	Anderson Mori & Tomotsune: Kenichi Sadaka & Aoi Inoue	101
16	Kazakhstan	GRATA International: Saule Akhmetova & Timur Berekmoinov	109
17	Portugal	Cuatrecasas: Vasco Bivar de Azevedo & Mónica Pimenta	118
18	Romania	RUBIN MEYER DORU & TRANDAFIR: Cristina Tararache	127
19	Russia	GRATA International: Yana Dianova	134
20	South Africa	Smit & Van Wyk, Inc.: Esmari Jonker	143
21	Switzerland	Badertscher Attorneys at Law: Dr. Jeannette Wibmer	150
22	Turkey	GUNER legal: Haşmet Ozan Güner	157
23	Ukraine	Gorodissky & Partners (Ukraine): Nina Moshynska	164
24	USA	The Richard L. Rosen Law Firm, PLLC: Richard L. Rosen & Leonard S. Salis	174

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Kazakhstan



Saule Akhmetova



Timur Berekmoynov

GRATA International

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The legislation of Kazakhstan uses the term ‘franchising’ (or ‘complex business licence’), which has the following meaning: an entrepreneurial activity, where the franchisor provides a set of exclusive rights for use to another entity/person on a remuneration basis. In accordance with the Law of the Republic of Kazakhstan dated 24 June 2002, No. 330-II ‘On complex business licences (Franchising)’ (hereinafter – the ‘Franchising Law’), under the complex business licence agreement, one party (the complex licensor) undertakes to provide the other party (the complex licensee), on a remuneration basis, with a set of exclusive rights (licence complex), including, in particular, the right to use the brand name of the licensor and protected commercial data, as well as other objects of exclusive rights (trademarks, service marks, patents, etc.) provided by the agreement for use in the licensee’s business activities.

1.2 What laws regulate the offer and sale of franchises?

Franchises are guided by the Civil Code of the Republic of Kazakhstan (hereinafter – the ‘Civil Code’), the Franchising Law, the Law of the Republic of Kazakhstan dated 26 July 1999, No. 456-I ‘On Trademarks, Service Marks and Appellations of Origin’ (hereinafter – the ‘Trademarks Law’), the Patent Law of the Republic of Kazakhstan dated 16 July 1999 and other acts.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for the purposes of any franchise disclosure or registration laws?

Yes, such a person will be treated as a “franchisee” for the purpose of any franchise disclosure or registration laws.

1.4 Are there any registration requirements relating to the franchise system?

Yes, Kazakhstani legislation requires the obligatory registration of franchise agreements, which should include terms and conditions of the transfer of the exclusive rights for inventions, utility models, industrial designs, selection achievements, trademarks, service

marks, and topographies of integrated circuits, registered under the laws of the Republic of Kazakhstan. Registration is carried out by the Ministry of Justice of the Republic of Kazakhstan (hereinafter – the ‘competent authority’). Failure to comply with the registration requirement shall entail the invalidity of the agreement.

The franchise agreement for the IP objects not registered in Kazakhstan can be filed for registration with the competent authority at the discretion of the parties to the franchise agreement.

A franchise agreement shall be filed for registration not later than six months after the commencement date.

Note: the draft *Law on Amendments to Legal Acts Regulating Intellectual Property* is providing obligatory registration of franchise agreements regardless of local or international registration of trademarks, patents and other rights transferred under the franchise agreement. The changes in the registration procedure itself are expected to be introduced by the draft law.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, there are pre-sale franchise disclosures that may apply to franchise transactions before a franchise agreement is signed. The Franchising Law states that, prior to the execution of a franchise agreement, the franchisor shall provide a potential franchisee with information about the exclusive rights that are given to the franchise, when entering into the franchise agreement. In practice, as the case may be, this provision can be interpreted both as a franchisor’s right and as a franchisor’s obligation. However, the franchisor is obliged to warn a potential franchisee about the confidential commercial nature of such information.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

The obligations set out under question 1.4 above apply to the master franchisee as soon as it begins to exercise its own rights under a master franchise agreement. Basically, in this case the master franchisee, as a contractual partner of the sub-franchisee, is obliged to fulfil these obligations. Therefore, we consider that pre-sale disclosure, in case of a sub-franchise agreement, falls within the responsibility of the (master) franchisee under the main franchise agreement rather than the franchisor.

In this respect, disclosure under the sub-franchise agreement is required from the (master) franchisee, unless otherwise provided by the franchise agreement.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The legislation of Kazakhstan does not provide for any specific format or scope for disclosure. Parties to the agreement are free to decide the extent to which confidential information will be transmitted in accordance with the disclosure agreement.

The relevant disclosures underlying the franchise relationship shall be sufficient for the other side to exercise its contractual rights and obligations. The issue of disclosure updates will normally be subject to agreement between the parties.

1.8 Are there any other requirements that must be met before a franchise may be offered or sold?

The laws and other regulations of Kazakhstan do not provide for specific requirements for the franchise before it is offered or sold.

1.9 Is membership of any national franchise association mandatory or commercially advisable?

Membership of the Franchise Association of Kazakhstan is not mandatory in Kazakhstan. Although the Franchise Association of Kazakhstan does not have any regulatory power, it may give certain useful practical recommendations and tips on doing franchising business in the Kazakhstani market.

1.10 Does membership of a national franchise association impose any additional obligations on franchisors?

One of the additional obligations may be a membership fee.

1.11 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

The Law of the Republic of Kazakhstan dated 11 July 1997, No. 151-I 'On Languages in Kazakhstan' (hereinafter – the 'Language Law'), requires that all agreements be made in the Kazakh language and in the Russian language with a translation into the language acceptable to the parties if necessary. In practice, some agreements are executed in three languages: Kazakh; Russian; and English. The parties may contractually agree on which version shall prevail, if there are inconsistencies between these texts.

This is a general requirement for all types of agreements, including franchise agreements and disclosure agreements.

There is no legislative requirement for other types of disclosure documents to be in a local language, but from a practical perspective it is advisable that the disclosure documents be in a language understandable to a Kazakhstani party.

The costs and timescale for translation depends on the volume of documents to be translated and translation experience and qualifications.

2 Business Organisations Through Which a Franchised Business can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

For the most part, there are no legal restrictions on non-nationals in respect of the ownership or control of a business in Kazakhstan. Indeed, any business, including in the franchising area, shall comply with all relevant laws and regulations governing agreements, performance of obligations and the conducting of business operations in general.

At the same time, certain areas of investment are of strategic importance to the Kazakhstani government to protect state defence and national security.

Hence, a special licence or permission from the government has to be obtained before investing and/or transacting within certain industries (e.g. encryption, weaponry, space and aviation). The media and telecoms sectors have certain restrictions in terms of corporate ownership and control as well.

2.2 What forms of business entity are typically used by franchisors?

In Kazakhstan, there are two main and most widely used forms of legal entities: the limited liability partnership (hereinafter – 'LLP'); and the joint-stock company (hereinafter – 'JSC'). The main difference is that the charter capital in a JSC is divided into shares, while the charter capital in an LLP is divided into interests. Accordingly, interests in the charter capital of an LLP are property rights of the participants, while a share is a security. A foreign franchisor may also establish a wholly-owned subsidiary or a joint venture jointly with other companies or individuals, whether foreign or local.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

There is no requirement for a foreign company to be registered in Kazakhstan. A foreign business entity is free to offer and sell a franchise directly or indirectly to a Kazakhstani business entity. Namely, the foreign business entity (franchisor) may conclude a franchise agreement with the Kazakhstani business entity (franchisee), or engage another foreign partner (franchisee) to sell a sub-franchise to the Kazakhstani company (sub-franchisee) under a sub-franchise agreement. There is no legal requirement or imperative to set up a new special Kazakhstani business entity as a pre-condition for performing franchising activities in Kazakhstan.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Competition protection issues are regulated by the Entrepreneurial Code of the Republic of Kazakhstan dated 29 October 2015, No. 375-V (hereinafter – the 'Entrepreneurial Code'). It prevents monopolistic (anti-competitive) activities, stops abuse of dominance and prohibits unfair competition. The requirements/restrictions of

the Entrepreneurial Code to the anti-competitive agreements are not applicable to the agreements on performance of exclusive rights to the intellectual property, trade names, means of individualisation of production, works or services. However, where such agreements cause or may cause restriction or elimination of competition, the antimonopoly authority may apply to court to void such agreements. These provisions refer to the franchise agreements as well.

However, the Civil Code of Kazakhstan contains some restrictive conditions for franchisees.

A complex business licence agreement may provide for restrictive (exclusive) conditions, in particular: (i) the obligation of the licensor not to grant other similar complex business licences for their use in the territory assigned to the licensee or to refrain from immediate self-employment in this area; (ii) the obligation of the licensee not to compete with the licensor in the territory of the complex business licence application in respect of a business performed by the licensee with exclusive rights belonging to the licensor; (iii) failure of the licensee to obtain other complex business licences from competitors (or potential competitors) of the licensor; and (iv) the obligation of the licensee to agree with the licensor upon the location, external and internal design of the premises used in exercising exclusive rights given by the agreement.

Some restrictive terms of the franchise agreements are void according to the Civil Code of Kazakhstan, namely: (i) the franchisor's right to determine the sale price or set an upper or lower limit of the price; and (ii) the terms defining the certain category of customers/buyers or the customers/buyers location/place of residence on the territory.

As mentioned above, the Entrepreneurial Code prohibits unfair competition. Accordingly, dissemination of false information that may damage the operating business entity is not allowed. The Code also bans the marketing of goods if intellectual property subject matters affixed to such goods are unlawfully or illegally used. It also prevents unfair competition in cases where other persons acquire and use intellectual property rights in bad faith.

3.2 Is there a maximum permitted term for a franchise agreement?

Parties to a franchise agreement are free to enter into a franchise agreement for any term. The law does not set any maximum term requirements.

3.3 Is there a maximum permitted term for any related product supply agreement?

The law does not limit parties when they establish the term of a product supply agreement related to a franchise agreement.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

The Civil Code forbids the franchisor from determining the price of goods for sale by the franchisee or the price of works (services) performed (provided) by the franchisee, or to establish an upper or lower limit of the said prices.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

The laws of Kazakhstan do not provide for any obligations on the franchisor when offering a franchise in adjoining areas. Any such

obligations might be foreseen in the contractual arrangements made between the parties, taking into account the feasibility of each individual business plan of neighbouring franchisees.

A franchisee may have claims against a franchisor for unfair competition in case of encroachment, mainly if that franchisee is expressly protected in the franchise contract for a certain area/territory. That means that if the franchisor had kept the right to act even in the franchisee's territory or area, or if the territory of the franchisee is not expressly protected in the contract, the latter will have to prove that he suffered damage and that this is due to the franchisor's acts and fault.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

In-term and post-term non-compete and non-solicitation restrictive covenants may be enforceable under local law.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The legal protection of a trademark is ensured on the basis of its registration with the Ministry of Justice of Kazakhstan, or is otherwise based on the international treaties to which Kazakhstan is a party. When the trademark is registered it is entered into the Trademark Register and will be valid for 10 years. Trademark registration may be renewed for another 10 years for an unlimited number of times. The owner shall start using the trademark within three years after its registration. If the mark is not used during the three-year term upon the trademark's registration, any interested person may apply for cancellation of trademark protection on the grounds of its non-use.

An unregistered mark may be used by any third person or company and there are very limited possibilities to prohibit such use. Also an unregistered mark can be registered as a trademark by a third company and it is extremely difficult to prevent or appeal such a registration.

Infringement of trademark rights leads to liability and sanctions in accordance with Kazakhstani law. The trademark owner is entitled to commence administrative, civil or criminal proceedings against the infringer(s) depending on the circumstances surrounding the matter and remedies available.

Trademark registration will be the first key element in every franchise transaction.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Know-how, trade secrets and confidential information are governed by the provisions of the Civil Code and the Entrepreneurial Code. In accordance with the Civil Code and the Entrepreneurial Code, the law protects information constituting an official or commercial secret, when the information has actual or potential commercial value by virtue of it being unknown to third parties, it not being freely accessible on a legal basis, and the owner of the information taking measures to protect its confidentiality. It is advisable to provide details of the type of confidential information and the obligation to keep it undisclosed also after the expiration of contractual relations.

Persons illegally obtaining such information, as well as employees in violation of their employment agreement – or counterparties in violation of a civil contract – disclosing proprietary or trade secrets, shall be obliged to compensate for the damage caused.

Protection of a commercial secret shall include a prohibition on obtaining the illegal obtainment, as well as on distributing or using the information.

The state enforcement agencies have rights to obtain necessary information only on the grounds of sanction by the prosecutor, a decision of the investigating authority or a court decision.

A breach of the obligation to keep information secret may lead to administrative or criminal responsibility.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright is protected in Kazakhstan by the Civil Code of Kazakhstan and the Law of the Republic of Kazakhstan ‘On Copyright and Related Rights’ dated 10 June 1996, as amended. Kazakhstan is a party to the Bern Convention for the Protection of Literary and Artistic Works.

Copyright of art works emerges by virtue of their creation; however, the registration of copyright is preferable for protection in cases of plagiarism and disputes, etc. The copyright does not apply to ideas, concepts, principles, methods, systems, processes, discoveries and facts.

In case of infringement of copyright (including software), the copyright owner may initiate civil or criminal proceedings before the court or enforcement agencies during the term of the franchise agreement or after the franchise agreement has expired or terminated.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The franchisee may file a lawsuit against the franchisor for breach of contract (i.e. for violation of contracted disclosure obligations). The franchisee is entitled to seek monetary relief if the court finds that some necessary information or assistance is withheld by the franchisor, or not provided in due course. Damages can be real and must be duly proved to be awarded. If the franchisee is able to show that failure of conveyance of the required information and/or assistance by franchisor is a material breach of the contract, the franchisee may have an option to rescind the contract. In any event, the enforcement of remedies shall depend on the circumstances surrounding the case and evidence of the breach in question.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Under the laws of Kazakhstan, and unless otherwise provided

by the Master Franchise Agreement or the relevant sub-franchise agreement, non-compliance related to disclosure or misrepresentation of data disclosed, whether it is incomplete, inaccurate or misleading, allocated between the franchisor and franchisee entails the franchisee’s liability under the Master Franchise Agreement. To avoid liability, the franchisor should clearly express the disclosure obligations and liability in the Master Franchise Agreement.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement?

There are no express rules governing these matters in Kazakhstan law. We consider that the franchisor may try to avoid liability for pre-contractual misrepresentation by including certain disclaimer clauses in the franchise agreement. However, in cases where the franchisor commits a material breach of the disclosure provisions, and in the event of losses suffered by the franchisee (due to disclosure non-compliance), the franchisee may bring an action for rescission of the agreement and reimbursement of damages.

5.4 Does the law permit class actions to be brought by a number of allegedly aggrieved claimants and, if so, are class action waiver clauses enforceable?

The legislation of Kazakhstan permits class actions to be brought by a number of allegedly aggrieved claimants. The legal standing, requirements and causes for such actions, as well as proceedings related to the same, are specifically described in the Civil Procedural Code of Kazakhstan.

Class action waiver clauses will not be enforceable in Kazakhstan when such a waiver is in conflict with the law or infringes anyone’s rights and legal interests. The Civil Procedural Code invalidates such a waiver of the right to apply for court protection.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no requirement for a franchise agreement to be governed by Kazakhstani law. Under the basic principles of international private law, the contracting parties are free to choose the relevant governing law when entering into a deal (or afterwards). Hence, the franchise agreement may be governed by the applicable foreign law.

However, if the agreement includes provisions relating to the rights to real estate located in Kazakhstan or relations among shareholders or transfer of equity interest in a Kazakhstani legal entity, such provisions are required to be governed by Kazakhstani law.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries’ courts, for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

The local courts will enforce orders granted by other countries’ courts for injunction against rogue franchisees, to prevent damage to a brand and misuse of confidential information. In practice, a court judgment from another jurisdiction may be enforceable in

Kazakhstan, provided that recognition and enforcement of the foreign court judgment is stipulated by the relevant international treaty to which Kazakhstan is a party.

Kazakhstan is a signatory to many multilateral and bilateral international treaties for recognition and enforcement of foreign judgments, including the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter – the ‘New York Convention’). Therefore, an arbitral award from another jurisdiction that is a signatory to the New York Convention may be enforceable as well.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

There is no typical length of term for a commercial property lease in Kazakhstan. It is up to the parties to decide how long they want to lease the property for.

Under the Civil Code of Kazakhstan, a tenancy agreement is entered into for the period specified by the agreement. When a tenancy agreement is signed with no indication of its term, it is deemed concluded for an indefinite term. Each party may withdraw from such agreement at any time by giving notice to the other party at least three months prior in the case of a real estate lease, and one month prior in the case of a lease of other property, unless otherwise established by the legislative acts or the agreement.

Upon the expiry of the agreement, a tenant has a pre-emptive right to enter into a tenancy agreement for a new term, subject to the following conditions:

- the tenant properly performed its obligations under the initial tenancy agreement;
- the tenant gives notice to the landlord, in writing, of its willingness to enter into such an agreement within the term specified in the tenancy agreement; and when no such term is specified in the agreement, then within the reasonable term before the expiry of the agreement; and
- the tenancy agreement does not contain provisions that deny the tenant’s pre-emptive right.

When entering into the tenancy agreement for a new term, terms and conditions thereof may be changed upon agreement between the parties.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant’s shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Under Kazakhstani law, tenants may assign their rights and obligations under the lease to a third party (franchisor or any other third party) upon the prior lessor’s written consent. Such consent can be provided for by the lease agreement or otherwise obtained. Please note that including optional or conditional lease assignment provisions into the franchise agreement on its own would not be sufficient; the lease agreement must also contain such provision in order to allow the franchisor to use it when required.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

With a few exceptions, foreign entities can hold proprietary rights over real estate in Kazakhstan. These exceptions are set by the Land Code of the Republic of Kazakhstan, dated 20 June 2003, as amended (hereinafter – the ‘Land Code’). Namely, foreign entities cannot own:

- land plots intended for conduct of commercial agriculture and forest planting; or
- land plots located in the frontier zone and frontier belt of the Republic of Kazakhstan.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease of a particular location)?

Unfortunately, we are not able to give the overview requested, because commercial terms of lease agreements are not in the public domain. From a legal perspective, however, the parties to a lease agreement may agree upon both of the above-mentioned methods, depending on their commercial and negotiating positions.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Kazakhstani legislation, including anti-trust law, does not prohibit the requirement of a franchisee to refer business leads that arise from outside his/her territory either to the franchisor (if the lead comes from a place that has not been allocated to another franchisee) or to the franchisee for the territory from which the business lead arose.

According to the legislation of Kazakhstan, it is possible to create an obligation for the franchisee to sell goods or provide services (including online trading) exclusively within the contracted territory. Restrictive provisions of anti-trust legislation are not applicable to licence and franchise agreements. At the same time, the relevant clauses in the franchise agreement obliging the franchisee to sell goods or provide services solely to the customers located or residing in the contracted territory shall be void according to the Civil Code of Republic of Kazakhstan. In this regard, the franchise agreement should have accurate wording in order to avoid incorrect application of the agreement.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no statutory limitations on the franchisor to require the former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. In this

case, the procedure for transfer of domain names should be clearly described in the contract.

In order to be sure that the former franchisee does not keep using a local domain name, it is recommended that the franchisor protects its trademark (wordmark) in the local jurisdiction as well (through application to the World Intellectual Property Organization (hereinafter – ‘WIPO’) or local patent office). Further, any use by the franchisee of the trademark (or similar mark) on the Internet or under a similar domain name, upon termination or expiration of the franchise agreement, may lead to trademark infringement and other penalties established by the law and the contract. Unless assigned in an amicable (non-judicial) manner, domain names may be recaptured in the course of civil proceedings through the agency of the competent court.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights that one might typically expect to see in a franchise agreement?

According to the Civil Code of the Republic of Kazakhstan, a franchise agreement concluded within a specified term can be terminated in accordance with the regulations of the Civil Code (Chapter 24), i.e. by the parties’ mutual agreement in case of material breach or in other cases provided by the agreement. The Civil Code provides an indemnity in case of material breach of agreement.

Please also note that according to the Civil Code a party to the agreement has the right to refuse an agreement for an indefinite term by giving six months’ prior notice to terminate, unless the agreement stipulates a longer period of notice.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee’s employees? If so, can anything be done to mitigate this risk?

There is no such risk. There are two different types of relations based on two different types of contract: relations between the franchisee and its employees based on the employment agreement; and relations between the franchisor and the franchisee based on the franchise agreement, which is a civil contract.

The franchisor and the franchisee are separate legal entities; therefore, they have their own labour and employment obligations. The franchisor and the franchisee operate on the basis of a franchise agreement that is primarily governed by civil law (i.e. the Civil Code of the Republic of Kazakhstan), while the labour and employment relations of the entities operating in Kazakhstan are regulated by the Labour Code of the Republic of Kazakhstan.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee’s employees in the performance of the franchisee’s franchised business? If so, can anything be done to mitigate this risk?

Pursuant to the Civil Code, the licensor shall be vicariously liable for the requirements imposed on the licensee with regard to the

inadequate quality of goods (or works or services) sold (performed or rendered) by the licensee under the agreement of a complex business licence.

As mentioned above, vicarious liability only arises on the claims for non-conformity of quality of goods or services. The franchisor is not liable for any other claims against the franchisee or its employees. It is recommended that this provision be clearly set out in the agreement to avoid any vicarious liability of the franchisor on other claims against the franchisee.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

According to the Law of the Republic of Kazakhstan, dated 13 June 2005, No. 57-III ‘On Currency Regulation and Control’ and the Rules of Performing Currency Operations in the Republic of Kazakhstan dated 28 April 2012, No. 154, payments from residents to non-residents of Kazakhstan under export/import of goods/services agreements (i) for a period of less than 180 days, and (ii) for an amount exceeding USD 100,000 require notification to the National Bank of the Republic of Kazakhstan (the notification is to be made by the arranging bank), and (i) for a period of more than 180 days, and (ii) for an amount exceeding USD 100,000, require registration with the National Bank of the Republic of Kazakhstan (the registration is to be initiated by the Kazakhstani party to the agreement).

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Royalty payments from a resident franchisee to a non-resident franchisor operating without a permanent establishment in Kazakhstan are subject to withholding tax at a rate of 15% unless reduced by a relevant double-tax treaty. As for other categories of payments under a franchise agreement, they would likely be taxed at a rate of 20%, unless another rate is established by an applicable double tax treaty (for example, withholding tax on management fees may be reduced to zero if the franchisor provides to the franchisee a certificate of residence complying with legislative requirements). As regards the option of structuring payments as a management service fee, this is in principle possible, but in this case the franchisee should be able to demonstrate to the tax authorities that the services have actually been rendered (including the relevant physical products of the services). Otherwise, the tax authorities may treat the payments as ‘other gains’ under the franchise agreement and claim the difference between the tax due on royalty payments and the tax (if any) actually paid, with the applicable penalties. The tax authorities will treat this payment to a non-resident as income, which under the tax laws is subject to a high rate of tax under the current Kazakhstani budget.

Please also note that due to the changes in tax legislation effective from 1 January 2016, royalty payments made by a franchisee which is recognised as an autonomous educational organisation, are exempted from the withholding tax in Kazakhstan. Autonomous

educational organisation refers to a non-commercial organisation established by the decision of the Parliament of Kazakhstan and involved in educational, healthcare or scientific activity.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

Under Kazakhstani law, all payments between Kazakhstani residents shall be made in local currency only. Payments can only be made in a foreign currency when at least one of the parties is a non-resident.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

The Law on Franchise provides that the agent could be a third party to franchise agreement. The obligations and liabilities of the franchisor, franchisee and the agent should be agreed in the agreement. In practice, agents are not parties to the franchise agreement.

When an agreement is expressly meant to be a franchise agreement, we believe that there cannot be any risk of interpreting such an agreement as an agency agreement. However, it would be advisable to include in the agreement a provision expressly establishing that the agreement does not create agency relations between the franchisor and franchisee and the franchisee acts as an independent party.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Pursuant to the Civil Code, citizens and legal entities must act in good faith, reasonably and fairly when exercising their rights, and comply with the requirements contained in legislation and the moral principles of the society. This obligation cannot be excluded or restricted by any agreement. The good faith, reasonableness and fairness of the acts of participants in civil rights relations shall be presumed. 'Good faith' and 'fairness' are understood as compliance with ethical principles in exercising rights. 'Bad faith' may be represented by a conscious disregard for the interests of other persons for one's own benefit, or by a negligent attitude to another's property, etc. For instance, a bad-faith owner is a person, who understands that he purchases property from a counterparty, which may not sell that property. As to fairness, it is stated that no one can exercise a right in breach of the principles of fairness. For instance, it is unfair to claim a share of costs and profits in a joint undertaking if such share does not correspond to the participants' input. 'Reasonableness' means the state of having sound judgment of circumstances related to the exercising of the right. A neglectful attitude to the appraisal of such circumstances is considered unreasonable. For instance, it is unreasonable to ask a person to do or provide something, when he (although acting in good faith) does not possess sufficient knowledge or experience in a particular area. However, there is no 'objective test' for these categories. Thus, the court decision will be based on the individual circumstances of a particular case.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

Once the franchise agreement is entered into, the relationship between franchisor and franchisee is governed and regulated by the local contract, corporate, anti-corruption, unfair competition, environmental, tax, advertising and promotion laws, as well as other Kazakhstani laws and regulations.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Under Kazakhstani law, there are no special disclosure obligations in relation to the renewal of an existing franchise at the end of the franchise agreement. We believe that upon the renewal of a franchise agreement, the franchisor would be required to update the franchisee on any matters not covered by the continuing disclosures.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There is no overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

Pursuant to Kazakhstani law, liability of a franchisor for the refusal to renew or extend the franchise agreement may arise only if the relevant obligation of the franchisor is provided for by the franchise agreement.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes as provided by the Franchise Law. If stipulated in a franchise agreement, a franchisor may effectively restrict a franchisee's ability to transfer its status or obligations under the franchise agreement. A franchise agreement usually requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. The Franchise Law also provides a pre-emptive right of a franchisor in case of alienation by the franchisee, its business or part of it. And the violation of a franchisor's pre-emptive right leads to voidability of such transaction.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

The ‘step-in’ right is recognised under Kazakhstani law and is enforceable in practice in Kazakhstan. If the franchise agreement is terminated, the franchisor may ‘step into the shoes’ of the former franchisee and acquire its rights and obligations in due course, following necessary legal procedures. Such ‘step-in’ may be realised in various forms and must be registered with the competent authority in order to be enforceable.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the country and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

We believe that, depending on the particular case, such power of attorney is not always enough to enter into the ownership and

management of a franchisee’s franchised business. Therefore, in various cases additional formalities may be required; for instance, a decision of shareholders or participants of the franchisee, consent of the franchisee, any other agreements, approvals, etc. In any case, it is certain that the courts will examine very carefully the conditions under which the said power of attorney was concluded by the franchisee, and if they decide that it was a result of the pressure of the franchisor to the franchisee, they can render it invalid. However, there are no registration formalities required for the validity of the power of attorney in accordance with the legislation of Kazakhstan.

Note

The answers are given in accordance with the current laws; however, by the publication date some changes are possible.



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