

FEATURE AND LEGAL REGULATIONS OF FRANCHISING IN MONGOLIA



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> 22

countries of presence



> 31

years of experience



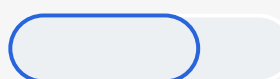
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professionals



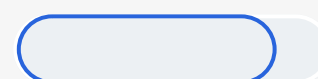
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practice areas



7700+

clients



15 000+

projects

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DEFINITION

Franchise

- ▶ In general, a franchise is a method of distributing products or services involving a franchisor, who establishes the brand's trademark or trade name and a business system, and a franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system according to the definition by the International Franchise Association. Further, according to the Investopedia definition, a franchise is joint venture between a franchisor and a franchisee. The franchisor is the original business. It sells the right to use its name and idea. The franchisee buys this right to sell the franchisor's goods or services under an existing business model and trademark.

Although there is no express definition of franchise in the legal framework of Mongolia, a franchise agreement is incorporated in the Civil Code of Mongolia (2002) as one type of contracts. Under a franchise agreement, a franchisor grants to a franchisee license for the use of intangible assets such as firm name, trademark, service mark, product design, packaging, as well as a business management system, plan, communication, business types to obtain goods, products, works, and services. On the other hand, the franchisee operates in accordance with the system and cooperation program developed by the franchisor, and pays appropriate royalty, fee, or a certain percentage of the income.

Difference from other forms of commercial activity

Franchise differs from other forms of commercial activity in a sense that it provides an opportunity to operate an existing, successful business model that comes with a proven track record, a successful training program, solid supply chain, and expert technical support.

◀ TYPES OF INTELLECTUAL PROPERTY RIGHTS



Trademarks

(a sign capable of distinguishing the goods or services of one enterprise from those of other enterprises);



Service marks

(a mark used to distinguish the services provided by one person or company from services provide by others);



Trade names

(the name given to a product by the company that produces it; a name that is taken and used by a company for business purposes (Oxford Dictionary));



Patents

(an exclusive right granted for an invention, which is a product or a process that provides, in general, a new way of doing something, or offers a new technical solution to a problem);



Trade secrets

(IP rights on confidential information which may be sold or licensed, such as commercially valuable information that is known only to a limited group of persons and is subject to reasonable steps taken by the rightful holder of the information to keep it secret , including the use of confidentiality agreements for business partners and employees);



Confidential information or know-how

(totality of the documents, schemes, information, specifically knowledge that are used in order to create and promote a particular product); and



Copyrights

(a type of intellectual property that protects original works of authorship as soon as an author fixes the work in a tangible form of expression) and designs.

FRANCHISE AGREEMENT

As Mongolia is a free market economy country, freedom of contract applies to contractual relationship. Unless otherwise prohibited or restricted by the law, parties to a contract are free to conclude any kind of transactions. Key concern is whether such a transaction is lawful and valid.

According to the Civil Code of Mongolia, transactions are valid as long as key terms and conditions which vary for different types of contracts are expressly agreed upon and due formalization (i.e. to be in writing, notarized, registered, signed by a legally capable and authorized person, etc.) is carried out.



For franchising agreement, it is required to be made in writing. The following terms and conditions must be specified mandatorily, among other things:

- Subject of the agreement;
- Fees;
- Duration of the agreement;
- Procedure for termination/cancellation and extension of the agreement;
- Responsibilities of the parties;
- Program for implementation of the agreement.

Also, it is essential to conclude confidentiality agreement or include confidentiality clause, as well as to set territory limit.

Legal requirements for advertising franchises

▶ Aside from the agreement between the parties, advertising must be carried out in accordance with the Law of Mongolia on Advertising. Certain restrictions and prohibitions apply to any advertisements which are disseminated in the territory of Mongolia, including:

- Any advertisement on licensed activities while the license is not obtained;
- Any advertisement on prohibited products;
- Any advertisement on products subject to non-tariff restrictions;
- Any advertisement on products that are not accredited (where required);
- Any advertisement that may lead to actions and activities that violate the laws of Mongolia;
- Any advertisement on projects in advance of conducting environmental impact assessment (where required), or the project may not be implemented according to the assessment;
- Any advertisement that may cause fear, violence, or immorality, as well as actions and activities that may harm human life, health or safety;
- Any advertisement on products which are prohibited from being promoted/advertised.

▶ The following advertisements are deemed as illegal:

- Advertisement on products comparing them with other products;
- Advertisement that is contrary to the reputation, good name, and business reputation of others;
- Advertisement that mislead consumers by omitting specific information, or taking advantage of their lack of knowledge, experience, or credulity;
- Advertisement that mislead consumers about the following information:
 - o intended use, structure, component, manufactured date, method, features, instruction of use, duration, quality certificate, conformity mark, quality assurance, quantity, origin of the product;
 - o quantity, size, availability of the products, actual market demand and supply of the product;
 - o current price, additional payment terms and conditions;
 - o the right to use and administer intellectual property;
 - o warranty and lifetime of the product;
 - o prize, certificate, and other acknowledgements;
 - o assessments, feedbacks, and recommendations by consumers;
 - o results of research, analysis, and test results, as well as scientific terms and quotations from other works;
 - o address, purpose and type of business, expertise and skills.
- Advertisement that defames other products;
- Advertisement that defame state symbols, historical figures, national currency and religion of Mongolia and other countries;
- Advertisement in which the uniform and symbol of a special government servant in an irregular and abnormal manner;
- Advertisement in which works of art included in the register of national, historical and cultural values are defamed;
- Advertisement in which language, comparisons, and images that denigrate ethnicity, language, race, social origin, status, age, gender, professional education, religion, or opinion are used; and
- Advertisement in which humaneness, morality, and customs that Mongolian people prefer are violated.

ADVERTISING FRANCHISES, RESTRICTIONS ON THE USE OF IP OBJECTS

Restrictions on the use of trademarks and other intellectual property objects



Before proceeding to the business activities, licensing agreement and other similar agreement under which relevant trademarks and intellectual property rights are granted need to be registered with the Intellectual Property Office of Mongolia to ensure the exercise of entitlements under the contract.

After due registration, franchisee is free to use the trademarks and other intellectual property objects without any restrictions, but in line with the agreement with the grantor.

FRANCHISE REGISTRATION AND LEGAL PROTECTION OF IP RIGHTS

Licensing agreements on inventions, utility models, product models, and trademarks that are subject to legal protection in Mongolia must be registered mandatorily. On the other hand, other agreements in regard to the use of intellectual properties may be registered voluntarily.

Licensee and licensor, or their authorized representatives are entitled to apply for the registration. For application, the following should be considered:

- ✓ An original or notarized copy of the licensing agreement is required.
- ✓ In the case of sub-licensing contract, the principal one is required.
- ✓ In the case of a contract concluded in a foreign language, its translation is required.

LIABILITIES OF PARTIES TO THE FRANCHISE AGREEMENT

Under general principles in the Civil Code, parties are liable for any damages and expenses incurred to the other party due to breach of contractual obligations and wrongful activities of the defaulting party.

Parties may agree to impose penalty (up to

50%

of the outstanding obligations) or undue loss (up to

0.5%

of the outstanding obligation for each day of delay) for breach of contractual obligations.

As specifically specified in franchise agreement section under the Civil Code,

- Parties are liable for implementation of contractual obligations and the accuracy information provided.
- In the case of any damage and expenses incurred to the Franchisor in regard to contractual obligations of the Franchisee, the Franchisee shall compensate for such damages and expenses.
- The Franchisor is not liable for any potential revenues the Franchisee may earn under the franchising contract.
- The Franchisor is not liable for any damages incurred to customers/clients due to wrongful activities of the Franchisee.

Additionally, Franchisor is entitled to prohibit the Franchisee from conducting competitive activities on a specific territory for a period of up to one year after expiration or early termination of the franchise agreement. However, such a prohibition must not cause substantial damage to the principal activities of the Franchisee. Otherwise, the Franchisor have to pay appropriate compensation.

◀ TERMINATION OF FRANCHISE AGREEMENT, RETURN OF PROPERTY USED IN THE FRANCHISE



Term (duration) of a franchise agreement is up to the parties' discretion in consideration of the market demand and sales market of the goods, works, or services.

If the contract is concluded for a period of more than 10 years and termination/cancellation condition is not specified therein, either party may terminate the contract after 10 years within one year from the termination notice sent to the other party. Thus, it is crucial to explicitly agree on the termination condition.

There is no specific restriction or prohibition on the return of property used in the franchise. Parties should agree upon such terms and conditions particularly in their contracts.

◀ ANALYSIS OF LEGISLATION AND JUDICIAL PRACTICE

Franchise regulation is briefly in covered in 6 articles of the Civil Code of Mongolia. Generally, parties are free to determine the terms and conditions of the agreement without breaching the legal restrictions or prohibitions.

As franchise relation is fairly new in Mongolia, a few cases have been settled by Mongolian courts usually in connection with withdrawal from the contract due to non-fulfillment of obligations, or return of property after termination of the contract.



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