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FRANCHISE REGULATIONS IN MONGOLIA

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Franchise regulations in Mongolia

1. Introduction

There are several ways to start a business, including finding and running a new business, buying an existing business, or buying a franchise, etc. Nowadays, buying a franchise is the most commonly used form. Under a franchise agreement, a franchisor undertakes to grant to the franchisee a license established in accordance with the procedure, for the use of its intangible assets such as the firm's name, trademarks or service marks, industrial design, packaging, as well as business management systems, planning, communications, and principal guidelines on the procurement of goods and services. While a franchisee undertakes to conduct its activities in accordance with a system and cooperation program developed by the franchisor, as well as to pay proper fees or royalties. The franchise business allows the franchisee to operate under the franchisor's trademark and to bring its business model into the market in line with the franchisor's standard and benchmark.

There are three types of franchise, depending on the branch:

- *Product franchise* /selling or distributing products manufactured by the franchisor using the franchisor's trademark/;
- *Manufacturing franchise* / transferring the right to use the technology by providing raw materials to the manufacturer and ultimate producer who own the trade secrets of the production of the raw material and technology registered in the Intellectual Property Office/;
- *Service franchise* /granting the right to the engage in certain types of activities along with trademark to the franchisee/.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Bankruptcy risk is low. • The franchisee does not need to concern about marketing because of the use of trademarks of products and services that are already familiar to the market; 	<ul style="list-style-type: none"> • The franchisee pays an advance payment, fixed management fee and royalty to the franchisor. • The franchisee must buy goods only from the franchisor. • The business is restricted under a

<ul style="list-style-type: none"> • The franchisor provides the franchisee with a package of business services such as training, support for starting the business, methodology, and regular advice. • Previous work experience is not required as well as the franchisor provides with necessary training. • Small businesses will be able to compete with large businesses under the franchise program. • The franchisee has an exclusive right in its territory. • Financing the business is easier. For instance, banks are likely to provide loans for buying reputable franchises. 	<p>franchise agreement.</p> <ul style="list-style-type: none"> • It is important to have high human resource standards, as other franchisees may adversely affect your business reputation. • It is unable to sell the franchise without the consent of the franchisor. • A certain percentage of all profits and sales are regularly paid to the franchisor. • There is little opportunity to change or expand your business due to market conditions.
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2. Considerable regulations when concluding a franchise agreement

The regulation in Articles 333-338 of the Civil Code of Mongolia, adopted on January 10, 2002, is the franchise agreement. The franchise agreement generally regulates the obligations and responsibilities of the parties, the form and term of the agreement, and the limitation of competition. For example, franchising is regulated by the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973) in Japan. Law on Franchise in China was first passed in 1997 and updated in 2007. Germany does not have any franchise law or act however a Civil Code, Consumer Protection Law, Commercial Law, Competition Law, and Unfair Trade Law apply to the conclusion of franchise agreements.

Parties entering into a franchise agreement are advisable to set forth the terms and conditions in detail in their agreement, as the franchising is regulated too general under the Civil Code of Mongolia. For instance:

1. Payment. In order to implement the franchisor's idea in the market, the franchisor shall charge a fixed membership fee in return for previous activities, as well as a regular franchise fee during the term of the agreement. These include advance payment,

royalties and other payments (advertising, technical, software, electronic bank transfers, training, employee clothing, real estate, etc.).

2. Fine and undue loss. According to the Civil Code of Mongolia, a fine is a monetary payment to be paid by a party who has failed to perform or has improperly performed its obligation in the amount agreed in advance in the law and agreement or calculated on the basis of a fixed percentage of the value of the non-performed or improperly performed obligation. While the undue loss means a monetary payment to be paid by a party who has exceeded the deadline under the law or agreement in the amount not exceeding 0.5% of the outstanding value of the non-performed obligation per day. In practice, it is beneficial for the franchisee to set a low percentage of fines and penalties in the agreement.
3. Restrictions. It is prohibited to test and implement a new idea or transfer the franchise to a third party without the consent of the franchisor. Also, the franchisor tends to prevent the franchisee from the competition with it for a long term on a certain territory after the termination of the franchise agreement upon mutual agreement of the parties. However, such a restriction is limited to up to 1 year under the laws of Mongolia.
4. Termination of the agreement. The parties agree on the term of the agreement on the basis of the principle of freedom of contract. The agreement may be terminated upon expiration of the period agreed by the parties. Furthermore, if the agreement is concluded for a period of more than ten years, it is possible to terminate the agreement within one year upon delivering a notice on termination of the agreement after the expiration of ten years. On the other hand, the franchise agreement is a long-term legal relation, therefore, can be terminated upon reasonable justifications. These include emergency circumstances of hardships and force majeure or circumstances where the continuation or extension of the agreement is impossible in order to protect the rights and legitimate interests of the parties. It is also possible to terminate the agreement if the continuation or extension of the agreement may cause significant damage to one of the parties. In addition, if it is unable to perform the obligation due to one of the parties' fault, the agreement may be terminated by the other party.
5. Use of the intellectual property rights. Franchising is entirely a form of use of intellectual property. These include the use of inventions, industrial designs, utility models, service marks, and legal entity names, etc. The parties must set forth the ways and scope of the use of intellectual property rights and dispute resolution in detail in the

agreement.

6. Indemnity. The franchisee is obliged to indemnify the franchisor against damages and expenses incurred in connection with contractual obligations according to article 338 of the Civil Code of Mongolia. While the franchisor does not guarantee or is not held liable for the franchisee's income to earn as a result of the franchise agreement. In any contractual relationship, the parties are obligated to perform their obligation properly. Any party who has violated its contractual obligations must be held liable for it. In the case of a franchise agreement, the franchisee is liable for damages incurred to the franchisor whether intentionally or negligently. The franchisor shall be liable, regardless of whether it is provided in the law, for breach of its obligations (e.g. to provide accurate information) under the agreement. The franchisor is not responsible for the success of the franchise. In other words, the fact that the franchisee has not earned any income under the franchise activities does not constitute loss but a typical risk to the franchisee's business.
7. Applicable law. Choice of law is crucial for the settlement of disputes arising out of the agreement. The parties are entitled to choose the applicable law as agreed upon.
8. Dispute Resolution. If the parties consider that they are unable to settle their disputes themselves, they may have the disputes settled by the court, mediation, and arbitration.
 - Court – Disputes can be settled by three instance courts – the trial court, appellate court, and supreme court which is a time-consuming process.
 - Mediation – Parties to any agreement should consider mediation, a method of alternative dispute resolution, aside from arbitration. Mediation is essentially a negotiation facilitated by a neutral third party. Unlike arbitration, which takes a form more similar to trial, mediation doesn't involve decision making by the neutral third party, but seeks to find a mutually acceptable resolution or compromise between the parties. The role of the mediator is to interpret concerns, relay information between the parties, frame issues, and define the problems.
 - Arbitration – Arbitration is one of the formal non-judicial proceedings for dispute settlement and is considered a more efficient process compared to court for its quicker, low-cost, and flexible process and procedure. Parties are able to take control of some process of the arbitration e.g., the choice of several neutral third parties who shall settle their dispute. Arbitrators are usually more experienced than

judges and more flexible in the decision-making process because they specialize in particular types of disputes.

However, exclusive jurisdiction cannot be changed by mutual agreement of the parties, in particular, in the following cases:

- Disputes related to the ownership, possession and use of immovable property in the territory of Mongolia;
- Disputes arising in connection with reorganization and liquidation of a legal entity located in the territory of Mongolia or decision made by that legal entity, its branch, or representative office;
- Disputes related to the validity of entries in public registry of the court or other competent authority of Mongolia;
- Disputes related to the registration or receipt of an application for registration of patents, trademarks, or other intellectual property rights by a competent authority of Mongolia; and
- In the case where a court decision enforcement action has been taken in the territory of Mongolia or a relevant person applied for such action.

3. Franchise disclosure document

The franchise disclosure document is a legal document that the franchisor must disclose about franchise system and the agreements to the franchisee who sign to the franchise agreement before a franchise may be sold. According to the basic principles of civil law, it is the responsibility of both parties to obtain negative and positive information on the agreement before concluding the franchise agreement. The franchisee should be aware of the following 23 items in the franchise disclosure document such as information on franchisor, any parents and affiliates, business experience, litigation, bankruptcy, initial fees, other fees, initial investment, restriction on sources of products and services, franchisee's obligations, financing, franchisor's assistance, advertising, computer systems and training, territory, trademarks, information on patents and copyrights, obligation to participate in the actual operation of the franchise business, restrictions on what the franchisee may sell, renewal, termination, transfer, and dispute resolution, financial performance representations, financial statements, contracts, outlets and franchisee information and receipts.

This regulation is enshrined in the Civil code of Mongolia as follows: "The franchisor is obliged to provide the franchisee with the necessary information". According to the general



principles of civil law, it is prohibited for one party to enter into an agreement by providing false information to the other party. If inaccurate information is provided, the other party has the right to terminate the agreement promptly upon reasonable justifications, moreover, to demand compensation for damages.

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