



## Legal basis and features of the agreement about franchising

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### Abstract

This article deals with a complex business license (franchise agreement). In the introduction of this article it is briefly described the historical development of this type of agreements in medieval Europe and also in the Silk Road countries in the middle of the XIX and in the beginning of the XX centuries. Then the author gives the characteristics of the main legal acts of Uzbekistan in this sphere. The article continues with an interesting exploration of the legislation of foreign countries regarding the franchise agreement, particularly, of the post Soviet Union countries and the European Union member states as well as of the USA.

**Keywords:** franchise agreement, complex entrepreneurial license contract, and license contract

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### 1. Introduction

#### 1.1 Historical development of franchising

The history of legal regulation of relations of complex business license (franchise agreement), as the experts reckon, refers to medieval Europe.

However, one can argue about the occurrence of such legal structures not only in medieval Europe, but even earlier.

Particularly, in the conditions of development of ancient caravans and the Great Silk Road, there were forms of business organization, quite similar and identical to modern franchise relationship.

Namely, definite features of modern franchising in selling goods in other countries through the Silk Road and the opening of large stores by merchants in neighboring countries or trade missions can be noted.

Despite of legal norms touching the franchising have been reflected in legislation of Uzbekistan in the years of independence, its signs coincide with the medieval view of the trade craft, when the salesman of a merchant traveled to other cities and villages by order of the owner (protégé). Especially this relationship has been widely spread in the middle of the XIX and in the beginning of the XX centuries. For example, protégés of the famous shoemakers or calligraphers, who have the permission of these masters, produced and sold an analog of their goods or traded in the products made by masters, but on its own behalf.

#### 1.2 Characteristics of the legal basis of the contract of complex entrepreneurial license (franchise agreement) in the Republic of Uzbekistan.

Initial legal norms relating to the franchise agreement in Uzbekistan have been reflected in the Civil Code of the Republic of Uzbekistan, which came into force on January 1, 1997. Chapter 50 of the Civil Code of the Republic of Uzbekistan (articles 862-874) is devoted to legal regulation of the complex business license contract. In this chapter, it is provided descriptions associated with the contract of the complex entrepreneurial license, namely the procedure for drafting and registration, the restrictive terms of the contract,

the rights and obligations of the parties, the licensor's responsibility to the requirements of the licensee, the bases of contract termination.

A significant role in the system of legal norms, concerning the contract of complex entrepreneurial license (franchise agreement) in the Republic of Uzbekistan was played a Regulation on the procedure of state registration of contracts of complex business licenses (franchise agreements), approved by the Cabinet of Ministers of the Republic of Uzbekistan dated November 4, 2010 No.244. In this Regulation, it is described the procedure for state registration of the contract in detail. In particular, the Regulation defines the procedure of state registration of the contract, expressed in abstract form in Article 863 of the Civil Code of the Republic of Uzbekistan. In particular, in article 863, it is defined that «the contract of complex business license must be made in writing and is subject to the registration agency that carried out the registration of the legal entity or individual entrepreneur acting under the contract as a licensor», but not listed in any public body contract is subject to registration, if the licensor is from a foreign country. Unlike the Civil Code of Uzbekistan in paragraph 4 of the Regulation it is specified that if the licensor is registered as a legal entity or individual entrepreneur in a foreign country, the state registration of the franchise agreement (significant changes, additions or termination) is carried out by the registration authority of the Republic of Uzbekistan which carried out state registration of the legal entity or individual entrepreneur acting under the contract as a licensee.

In addition, the Regulation takes into account the special procedure of state registration of the contract of complex business license (franchise agreement) in case if it involves a franchise agreement, including the foreign trade (export-import of goods and services), exclusive rights to intellectual property. The complex of exclusive rights under the contract may include the company name, trademark, inventions, useful models, an industrial prototype, trade secrets, copyrights, and others. For this reason, the legal regulation of the contract of complex business license, besides to the Civil Code of the

Republic of Uzbekistan is made also by other normative documents, in particular, by the laws of the Republic of Uzbekistan «About trademarks, service marks and names of places of goods origin», «About accession of the Republic of Uzbekistan to the Patent Law Treaty adopted by the Diplomatic Conference on June 1, 2000 in Geneva» and «About an author's right and allied rights» of July 20, 2006 and others <sup>[1]</sup>.

In article 862 of the Civil Code of Uzbekistan it is determined that under the contract of complex entrepreneurial license (franchise agreement) one party (complex licensor) agrees to provide to other party (complex licensee) set of exclusive rights (license complex) for remuneration, which includes the right to use a trade name of the licensor and protected commercial information, as well as other objects of exclusive rights (trademark, service mark and inventions, etc.), provided by the contract, in business activities of the licensee.

The contract of complex entrepreneurial license provides for the use of the license complex, business reputation and commercial experience of the licensor in a certain volume (in particular, with the establishment of minimum and/or the maximum volume of use) with or without specifying the territory of use in relation to a particular field of activity (sale of goods received by the licensor or produced by the licensee, rendering services, performance of work, implementation of commercial activities, etc.).

### 1.3 Legal basis of the franchise agreement foreign countries.

The concept of the contract of complex entrepreneurial license (franchise contract) in different countries has a different formulation. For example, "franchising" in the US and Western Europe, in the Russian Federation and Ukraine is designated as "commercial concession", in Uzbekistan and Kazakhstan – as "complex entrepreneurial license (franchising), in Moldova (CC, article 1171), in Azerbaijan (CC, article 723) and Turkmenistan (CC, article 629) is designated as a "franchise." However, various formulation of the franchise agreement in foreign countries does not affect its value and meaning.

In many European countries, the Code of Ethics of franchising adopted in 1990 governs the relations connected with the franchise agreement. European Federation of Franchise with its members - franchising associations of Austria, Belgium, Denmark, Germany, France, Italy, the Netherlands, Portugal and the UK, in collaboration with the European Community Commission are worked above the Code of Ethics. The Code regulates the relations connected with the franchise agreement in each individual European country.

Besides, for the regulation of contracts on franchising, it has bases of the national legislation in each European country. Thus, regulation of relations connected with the franchise agreement, is performing by national law, European Union law and the norms of the European Code of franchising ethics. This circumstance is considered an original feature of the relations connected with the franchise agreement. That is, the relationship between the licensor and the licensee, organized and leading activity in the country, which is part of the European Union, may be regulated by the European code of franchising ethics, at the request of business entities operating in the country, which is member of the European Union. It is remarkable that the norms of the European Code

of franchising ethics are applied in countries that are not members of the European Union, but located on the European continent.

Today there are special regulations about franchising in the USA, at the federal level – "The set of franchising rules", enshrined in the United States Commercial Code, and territorial laws in 15 states of America, in Canada (at the provincial level), also in France, Australia, Spain, China, Indonesia and etc. <sup>[1]</sup>.

**1.4 The peculiar features of the complex business license contract (franchise agreement).** Features of the franchise agreement follow from the concept of the essence of the subject and the design of this contract.

It should be noted, the subject of complex business license contract (franchise agreement) is considered to be exceptional and has complex character, i.e., some rights from the licensor to the licensee are transferred immediately for a fixed term. These rights include the right of use the licensor's brand name and protected commercial information, as well as other objects of exclusive rights: trademark, service mark and inventions. In this case it is necessary to distinguish between these rights by the license agreements for the right to use intellectual property. Under the license contract, the party which holds the exclusive right to result of intellectual activity or to means of individualization (licensor) grants the other party (licensee) permission to use the object of intellectual property (part one, article 1036 of the Civil Code of Uzbekistan). The franchise agreement, in turn, implies the use of a complex of the exclusive rights in an entrepreneurial activity. If usually in the license contract it is given permission use of intellectual property for one or same type, or specific objects, objects used in franchising have complex character, i.e. refer to several objects of intellectual property, and also the purpose of use is directed only at the entrepreneurial activity.

The essence of the design of this contract consists in registration through the contract, which is considered as the private legal means of allowing use of exclusive rights that have unique aspects in civil law.

E.A. Kozina: franchising allows large companies to enter new market segments and expand the area of economic activity without additional capital investments through by providing to individual entrepreneurs the right to use the complex of exclusive rights to results of intellectual activity <sup>[3]</sup>.

According to R. Baldi, difficulties in a formulation of this definition due to a wide range of different shapes, in which it is implemented in business practice.

However, it should be noted the difference between the franchise and the concept of the complex entrepreneurial license contract (franchise agreement). Franchising is one of the ways of organizing business, thus, as the contract of complex entrepreneurial license (franchise agreement) is the civil law relation.

In the legal literature, in the Civil Code of the Republic of Uzbekistan it is noted a peculiar of sense in the formulation of «complex entrepreneurial license (franchise)»:

Firstly, such formulation (complex entrepreneurial license (franchising) of this contract follows from essence and values of the corresponding legal relations.

Secondly, the term "franchising" serves in the name of the contract for the appropriate use of its name.

Thirdly, the facilities, which are underlying contract, provided by one party (licensor) to another, can be captured only the term "complex entrepreneurship" [4].

In our opinion, the reason of why the franchise agreement is named as complex entrepreneurial license contract (franchise agreement) in the Civil Code of the Republic of Uzbekistan can be explained providing a complex of exclusive rights to the licensee the licensor. In general, this name is fully consistent with the practice and norms of international law.

It is possible to note that despite the differences in the name of the franchise agreement in foreign countries, the approach in the formulation of this concept does not differ. For example, according to the Civil Code of the Russian Federation, under the contract of commercial concession one party (franchisor) undertakes to provide to other party (user) for a period or without specifying the period of the right to use a complex of the exclusive rights belonging to the owner in an entrepreneurial activity of the user, and the user undertakes a duty of use of the rights and payment of assignments, taking into account the restrictions set in a legislative and contractual order [5].

O. A. Orlova notes full compliance of the majority of aspects of the contract of commercial concession of the Russian Federation and the franchise agreement of foreign countries [6].

M. I. Kulagin paid attention to the fact that a main objective of franchising activity of large producers is creation of system of goods distribution.

V. V. Pilyaeva claims that the contract of commercial concession (franchising) shows the relations between large and small business in itself [7].

Indeed, joining the scientists' opinion, who studied the franchise agreement, it should be noted that in most cases, large companies favor as licensor and licensee acts as - representatives of small business.

Increasing the number of licensees, leading activities on the base of complex business license contract (franchise agreement), demonstrates development by licensors new markets and occupancies. For instance, we will analyze the priority of the entrance of the large companies to another country based on franchising. There are more than hundred administrative and territorial units of the state level. Consequently, it is possible to organize the activities of more than hundred licensees. It is known, that all parts of the population tend to buy goods and services of the most well-known and reliable companies and firms. Therefore, leading the activity on the base of the contract of complex entrepreneurial license (franchise agreement) will be beneficial not only for people but also for representatives of business, acting as licensees and licensors. In the case of admittance of known brand into a new market through the branches, the expenses associated with the organization of activities of the branch, delivery of goods to the wholesale and retail trade agencies make up a significant amount of sum. Also, if the branch sustains economic losses or recognized economically not capable (declare bankruptcy), in this case the licensor will suffer material damage, the head company or firm is incumbent to the creditors of the branch.

In the sources it is noted the need for paying attention to the terms of the exclusive rights in the preparation of the franchise agreement [8].

## 1.5 According to the legislation of the Republic of Uzbekistan

- Patent for the invention is valid for 20 years (can last up to 5 years)
- For the selection achievements of 20 years (in some cases 25 years)
- Patent for the industrial design - 10 years
- Patent for useful model - 5 years
- Trademark - 10 years;
- Integral Circuits - 10 years [9].

Therefore, in the process of drawing up the contract of complex entrepreneurial license (franchise agreement), the parties should pay attention to the duration of the intellectual property.

Characteristic features of the franchise agreement can be recognized as follows:

- only business entities may participate as parties of the contract;
- the licensee has the right to use a complex of licenses, according to the contract, only in the specified territory;
- presence of restrictive terms of the contract;
- ability to specify by the licensee involvement of additional licensees not as the right, but as the obligation in the contract.

Complex of licenses is issued to the licensee in accordance with the contract of franchise. However, it should not be deduced that the franchise agreement is one of the types of the license agreement. Paying attention to the terminology of the franchise agreement in the domestic legislation, S.S.Khamroev claims that the license is an administrative document, which cannot be issued by the person who does not have an appropriate authorized for that jurisdiction [10].

Being an opponent of this idea, E.A. Sukhanov asserts that the contract should not be considered a commercial concession (franchise agreement) as one of the varieties of the license agreement [11].

Besides, regulation of relations connected with licensing certain types of activities that require a license in the Republic of Uzbekistan, is carried out according to the Law of the Republic of Uzbekistan "About licensing of certain activities", adopted on May 25, 2000. As stated in this law, it does not apply to relations arising under a contract of complex entrepreneurial license (franchise agreement) [12].

From this, it can be concluded that the agreement on the complex entrepreneurial license (franchise agreement) is not a license agreement. Consequently, the term "license" in the franchise agreement does not imply the authorization procedure by the public authorities.

According to the Civil Code of the Republic of Uzbekistan, if the period of the complex entrepreneurial license agreement is not specified, each party has the right at any time to terminate the termless contract of complex entrepreneurial license, if the contract does not provide for a longer period, the other party must be notified of this in 6 months prior to termination.

In most cases, the period is specified in the franchise agreement, and further the period shall be extended for an indefinite period. That is, first, is checked for or not prospects, if the prospects of activity is identified in the practice, with the consent of both parties, the contract is extended.

### 1.6 In theory of civil law, franchise is divided into the following types

- Product franchise
- Industrial franchise
- Business franchise
- Corporate franchise
- Conversion franchise
- Regional franchise

### 1.7 L. T. Ibadova, depending on the scope of the granted rights, allocates two types of franchise agreement

- Dealer, in which small company distributes products of the head company or provides services on its behalf, receiving a certain share from sales volume;
- Corporate, where besides independent use of the trademark, product or service, the user (licensee) is connected to a full cycle of economic activities of the head company<sup>[13]</sup>.

In turn, L. Mayland noted three types of franchise: a personal franchise, business franchise and investment franchise<sup>[14]</sup>.

Obviously, while studying franchise agreement, scientists have used various approaches to the separation of franchise types. The reason for this can be considered as a wide variety of spheres of business activity, where franchise agreements are applied.

Today the implementation of the franchise agreement in all areas of production of goods and services, promotes expansion of the number of types of franchise agreements. For this reason, it is not possible to make a concrete list of types of franchise agreements.

In general, franchise agreement is a separate type of contract, which is used in the description of the various approaches, however, they all have a common character, i.e., there are no significant differences among views, describing the agreement. It can be explained by the fact that franchising in many countries it is one of the new types of contract and is used in business recently.

It is known that there is a similarity of the contract of the complex entrepreneurial license (franchise agreement) in contents and subject with some other contracts. The license contract and the contract of trust management of property are among such contracts.

According to S. Safoeva, under the license agreement it is understood the civil agreement on providing the intellectual property right (licensor) for the owner to use intellectual property rights purposefully under the legal protection and procedures established by a licensee in the contract on the one hand, and payment of the product, the use of the above-mentioned rights, the purpose and order the other party (licensee) stipulated in the contract<sup>[15]</sup>.

Despite the similarity of complex entrepreneurial license contract (franchise agreement) and the licensing agreement on the subject, there is a difference between them in the subject and the subject field. As if one facility is provided under the license agreement, then according to the franchise agreement, the licensee is granted a complex of the exclusive rights. Furthermore, only subjects of business act as subjects of the franchise agreement. At the time, as in the license agreement concerning intellectual property, any natural or legal person may be a party of the agreement.

In accordance with the contract of trust management of property, the person acting as the owner of the trust property, i.e. (settlor) transfers to other party, the trustee for a period

assets in trust, for management of the property in the interests of the founder or the person on its behalf - the beneficiary<sup>[16]</sup>.

The contract of complex entrepreneurial license just passed the complex of exclusive rights is also delivered from the licensor to the licensee in trust management. In this case, the licensee carries out the complex of exclusive rights, not only in their own interests, but also in the interest of the licensor. It uses and has the complex of exclusive rights in accordance with the contract requirements, like the possession of the property for the purpose of benefits of the founder or the beneficiary.

Another similarity is that both the trustee and the licensee have no authority to dispose of the property and the complex of the rights without consent of the founder and the licensor.

The agreement of complex entrepreneurial license (franchise agreement) and property trust management agreement have the following distinctive aspects:

Firstly, if the subject of the complex enterprise license can act only the complex of the exclusive rights, then the list of the property, which is subject of the contract of trust management of property, can be wider and include the enterprises and other property complexes, separate objects relating to real estate, securities, the individual rights and other property.

Secondly, asset management entities also may act individuals. At the time, both as a subject of complex entrepreneurial license contract (franchise agreement) may make only commercial organizations and citizens registered as an entrepreneur.

Considering the fact that foreign entrepreneurs and legal entities registered in foreign countries act as the treaty party of the complex entrepreneurial license contract (franchise agreement), it can be argued about the need for the international law governing relations in this sphere. S. Klimov proposes to develop a legal document regulating international franchise relationship in his research work.

If to consider participation of representatives of entrepreneurship, organized and leading activity in various countries, in the contract of the complex entrepreneurial license (franchise agreement), it is possible to reveal need of regulation of these relations on the base of the international precepts of law.

In general, the improvement and study the characteristics of complex entrepreneurial license (franchise agreement) plays a significant role in education and implementation of new forms of business and enterprise systems.

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