A 'Round the World Tour:

Sales Agency and Distribution Relationships

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CHINA and RUSSIA:

The Legal Environment

Paul Jones

Jones & Co.

Toronto, Canada

pjones@jonesco-law.ca

www.jonesco-law.ca

中华人民共和国

THE PEOPLE'S REPUBLIC OF CHINA

I. Introduction

China's emergence on to the world stage is causing dramatic changes in the way the world does business. Its population of 1.32129 billion[1] is between one-fifth and one-quarter of the world's total population. It is also the third largest country by territory, after Canada and Russia. This large population makes Chinese[2] the most common mother tongue in the world. It is becoming an increasingly popular second language to study and business leaders in various countries are calling for increased Mandarin studies.[3]

More significantly China's economy is now expected to overtake that of Japan in 2010 to become the second largest in the world. Despite the worldwide recession it appears that it still managed a growth rate of 8.3% in 2009. More cares were sold in China in 2009 than in the United States.

However China still has significant growth opportunities. The GDP per capita in nominal terms is only $2,461 USD ranking China 105th in the world.[4] There are significant income disparities within China and its Gini coefficient of .447[5] is said to exceed that of all developed countries.

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[1] For 2007 according to 中国人口与发展研究中心 (Zhongguo Renkou Yufazhan Yanjiu Zhongxin) – The China Population Development and Research Center, quoting the 国家统计局(Guojia Tongji Ju) National Bureau of Statistics Bulletin of February 28, 2008, available at: http://www.cpirc.org.cn/tjsj/tjsj_cy_detail.asp?id=9229 .

[2] Chinese consists of a number of dialects, including Mandarin (the dialect of Beijing, also known as Putonghua), Wu, Xiang, Gan, Hakka, Min and Yue, but is considered to have one writing system (that uses both traditional and simplified characters). Although Mandarin and Cantonese (Yue) are as different from each other as are Portuguese and Romanian, for political and cultural purposes Chinese is considered one language. See Charles N. Li and Sandra A. Thompson, MANDARIN CHINESE: A FUNCTIONAL REFERENCE GRAMMAR (Berkeley: University of California Press, 1981) at 2.

[3] See for example Alexandra Smith, *Lack of Mandarin speakers 'is holding UK economy back,'* GUARDIAN, July 26, 2006.

[4] International Monetary Fund, World Economic Outlook Database., as at April 2008 (for the year 2007), at http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx On a purchasing power parity basis the GDP per capita is $5,292 USD for a ranking of 99th.

[5] *The limitation of the Gini Coefficient in China,* PEOPLE'S DAILY ONLINE, July 20, 2006, available at: http://english.people.com.cn/200607/20/eng20060720_285083.html .

The closest developed countries are the United States and Singapore. In some major cities and coastal regions average GDP per capita is approaching $10,000.00 USD per annum.[6]

The political system is also in transition, but to what degree is much debated. China is no longer a command economy and the central planning committee structure has been broken into smaller and smaller pieces. The private sector is now estimated to account for more than half of China's GDP.[7] While the Chinese Communist Party is still in control, the image that this conjures up in the minds of westerners does not fit well with a government that actively seeks consultation with its own citizens on the new employment contract law[8] or with the American Bar Association on its intellectual property and antitrust laws.

II. Legal Structure and System

Officially China is a unitary and not a federal state. The second level of government in China consists of 22 provinces,[9] five autonomous regions,[10] and four municipalities directly under the authority of the central government.[11] But a dominant theme of Chinese history both under the emperors and the current regime can be summarized in the classical Chinese saying "山高皇帝远[12] - The mountains are high and the Emperor is far away." In other words local authorities are known to exercise power that is out of proportion to their official status.

China's constitution contains a very limited division of powers.[13] Each subordinate level of government can exercise the same powers as the national level (with certain exceptions) provided that they do not contradict or conflict with the laws and regulations adopted by a

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[6] *Chinese cities to include transients in per-capita GDP accounting,* XINHUANET, January 29, 2008, available online at: http://news.xinhuanet.com/english/2008-01/29/content_7520532.htm . Shanghai had a GDP per capita in 2007 of 65,000 RMB after adjustment for unregistered residents.

[7] Zhao Huanxin, *Private firms powering China economy,* CHINAdaily, September 22, 2006, available online at: http://www.chinadaily.com.cn/china/2006-09/22/content_694432.htm .

[8] 劳动合同法 (laodong hetong fa), adopted at the 28th Session of the Standing Committee of the Tenth National People's Congress on June 29, 2007 and came into force on January 1, 2008.

[9] Heilongjiang, Jilin, Liaoning, Hebei, Henan, Anhui, Shandong, Jiangsu, Zhejiang, Shanxi, Shaanxi, Hubei, Hunan, Jiangxi, Fujian, Guangdong, Hainan, Sichuan, Yunnan, Guizhou, Gansu and Qinghai.

[10] Ningxia, Inner Mongolia, Guangxi, Xinjiang and Tibet.

[11] Beijing, Tianjin, Shanghai and Chongqing.

[12] Pronounced " Shan gao huangdi yuan."

[13] 中国人民共和国宪法 (Zhongguo Renmin Gongheguo Xianfa) adopted by the 5th National People's Congress on December 4, 1982, and in particular, Article 100.

superior level of government. In 2000 the Legislation Law[14] was adopted. It reserved a number of areas to the National People's congress or its Standing Committee such as criminal laws, the basic civil law system, the basic economic system and the systems of litigation and arbitration.

But until recently provincial governors were evaluated and promoted based on their success in economic development. This encouraged provincial authorities to adopt their own version of the laws where they felt that the national laws were unclear in order to favor local interests and developments. Some foreign investors have made the mistake of relying on such an approval from a local authority only to find their entry blocked when the national authorities became aware of the plans.

China is a civil law jurisdiction. A law reform process was initiated in 1902 when the Empress Dowager Cixi, one the last of the Qing Dynasty, was presented with a translation of the German Civil Code[15] that came into effect in 1900.[16] Japan had already adopted a civil code based on the German model in 1896. The officials were instructed to prepare a draft and it was presented to the Emperor on October 26, 1911 just weeks before the end of the dynasty. It was not until 1929-30 that a similar form of civil code was promulgated under the 国民党 (Guomindang) administration in Nanjing.

After the Cultural Revolution and with the initiation of the "reform and opening up"[17] policies in 1978 China started to rebuild its legal system. One of the first laws adopted was the General Principles of the Civil Law[18] which still functions as a sort of mini-civil code. To date China has looked to German law as has adopted two of the three major components of a civil code, the Contract Law[19] and the Property Rights Law.[20] The section "on persons" and civil rights is still in draft form. In December 2009 the Standing Committee of the National People's Congress adopted the new Tort Liability Law.[21]

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[14] 中华人民共和国立法法 (Zhonghua Renmin Gongheguo Lifa Fa) – Legislation Law of the People's Republic of China, adopted at the Third Session of the Ninth National People's Congress on March 15, 2000 that came into force on July 1, 2000, and in particular Chapter 2.

[15] *Bürgerliches Gesetzbuch* in der fassung vom 1 Januar 1900.

[16] Philip C.C. Huang, CODE CUSTOM AND LEGAL PRACTICE IN CHINA: THE QING AND THE REPUBLIC COMPARED (Stanford: Stanford University Press, 2001) at 16.

[17] 改革开放 (Gaige Kaifang), adopted at the December 1978 Third Plenum of the 11th CCP Congress.

[18] 中华人民共和国民法通则 (Zhonghua Renmin Gongheguo Minfa Tongze) adopted at the Fourth Session of the Sixth National People's Congress on April 12, 1986.

[19] 合同法 (Hetong Fa), adopted at the Second Session of the Ninth National People's Congress on March 15, 1999 and came into force on October 1, 1999.

[20] 物权法 (Wu Quan Fa) adopted at the 5th Session of the 10th National People's Congress on March 16, 2007, and came into effect on October 1, 2007.

[21] 侵权责任法 (Qinquan Zeren Fa) adopted at the 12th session of the Standing Committee of the Eleventh National People's Congress on December 26, 2009 to come into effect on July 1, 2010.

China has four levels of courts. At the top of the court structure is the Supreme People's Court. Below it at the provincial level are 31 Higher Level People's Courts. Underneath them are about 400 Intermediate Level People's Courts established in provinces, autonomous regions and within centrally administered cities. Finally at the bottom are over 3,000 Basic Level People's Courts. Counties in China can be quite large and as a significant portion of the population is rural, these courts have often established branch courts outside the towns in which they may be headquartered. All together China has almost 200,000 judges.[22]

Aside from the Supreme People's Court, the judges are not appointed by the central government. Rather they are appointed by the people's congress and the equivalent standing committee at the same level as the court. They do not have security of tenure and this is one of the reasons that they are more susceptible to local influences.

One of the questions often asked by foreigners considering doing business in China is whether the courts and judges are reliable and effective, and whether there is a bias against a foreign party in a Chinese court. Concerns are often expressed about the quality of the judges, about "local protectionism"[23] and about the transparency of the system.

The short answer is that Chinese courts and judges are significantly better than most foreigners expect, and are improving rapidly. Empirically it is harder to detect a bias against foreigners than it is to suggest one in favor of foreigners.

Firstly under China's Civil Procedure Law[24] major cases involving foreign elements are commenced in the Intermediate Level People's Courts, in the place of the defendant's residence. In distribution cases this usually means one of the major cities. Thus the case starts in a higher and more sophisticated court. Appeals are to the Higher Level People's Courts, of which there are only 31 in the country. Thus an appeal will be heard by a limited number of China's more sophisticated judges.

China has also raised the qualifications for becoming a judge in the amendments to the Judges Law in 2001.[25] In an effort to combat local protectionism the central government has allocated funds for the payment of judges to make them less dependent on the local government.

As in other civil law countries becoming a judge is usually a career choice made upon graduation from law school. The younger judges are better trained and appear to advance quickly. One of China's most famous cases involving local protectionism was decided against

[22] Jerome Cohen, Statement for the Congressional-Executive Commission on China Hearing, July 26, 2005; as reprinted in People's Daily at: http://english.people.com.cn/200508/15/eng20050815_202556.html .

[23] Known in Chinese as 地方保护主义 – difang baohu zhuyi.

[24] 中华人民共和国民事诉讼法, adopted at the Fourth Session of the Seventh National People's Congress on April 9, 1991, Article 19(1).

[25]中华人民共和国法官法 , adopted at the 12th session of the Standing Committee of the 8th National People's Congress on February 28, 1995; and amended at the 22nd session of the Standing Committee of the National People's Congress on June 30, 2001.

the local government by a 30 year old woman judge.[26] The local government tried unsuccessfully to get the decision overturned.

In the last few years the Chinese courts have been posting an ever increasing number of their decisions online.[27] While these posted decisions do not have precedential value they contribute greatly to the transparency of the legal system. Further judges are using these decisions to help them in deciding cases.[28]

Some might even say that Chinese courts favor foreign parties. After the patent ran out on Lego's "brick" it was able to protect the design on two grounds in China whereas in most other countries, including the United States and Canada, it obtained no further protection.[29]

III Laws of General Application

1. Contract Law

China has not yet completed the drafting of its civil code. The Contract Law is however the equivalent of the book (or chapter) on obligations in other civil law systems. Sales agency and distribution agreements must conform to the general provisions of the Contract Law[30] in addition to any requirements in any regulations.

In addition to the general provisions, the Contract Law also has specific chapters on Technology Contracts,[31] Entrustment Contracts,[32] Brokerage Contracts[33] and Intermediation Contracts.[34]

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[26] Known as the Luoyang Seed Case in 2003, it involved a choice between provincial and national laws. The judge followed the Legislation Law and ruled in favor of the national law, and the foreign party, against a local company. See Jim Yardley, *A young judge tests China's legal system,* THE NEW YORK TIMES, November 28, 2005.

[27] For example, there are thousands of intellectual property cases posted at: http://ipr.chinacourt.org/ ; and the decisions of the Beijing courts are posted here: http://bjgy.chinacourt.org/cpws/ .

[28] Liebman, Benjamin L. and Wu, Tim, *China's Network Justice* (January 9, 2007). Columbia Public Law Research Paper No. 07-143 Available at SSRN: http://ssrn.com/abstract=956310 .

[29] See for China -英特莱格公司 (Interlego S.A.) (Yingte Laige Gongsi) v. 可高（天津）玩具有限公司 (KeGao (Tianjin) Wanju Youxian Gongsi - KeGao (Tianjin) Toy Company), Beijing Higher People's Court, File No. 279, 2002-12-18; for Canada - Kirkbi AG *v.* Ritvik Holdings Inc., [2005] 3 S.C.R. 302 • (2005), 259 D.L.R. (4th) 577 • (2005), 43 C.P.R. (4th) 385; for the U.S. – Tyco Industries, Inc. v. LEGO Systems, Inc. and INTERLEGO A.G., Tyco Industries Inc. v. Lego Systems Inc., 5 U.S.P.Q.2d 1023 (D.N.J. 1987); affd 853 F.2d 921 (3d Cir. 1988); cert. denied 488 U.S. 955 (1988) .

[30] Articles 1 to 129.

[31] 技术合同 (Jishu Hetong), Chapter 18.

The specific provisions of these chapters override the general provisions of the Contract Law where the two conflict.

Drafting a civil code is always a long process and accordingly in 1986 China adopted as an interim measure to guide the development of a civil law legal system the General Principles of the Civil Law.[35] Article 4 of this Law requires that:

> 第四条 民事活动应当遵循自愿、公平、等价有偿、诚实信用的原则. (Article 4 - In civil activities, the principles of voluntariness, fairness, making compensation for equal value, honesty and credibility shall be observed.)[36]

It should be noted that despite this translation, the term used for "honesty" is 诚实 (chengshi). This is an invented term and is not familiar to ordinary speakers of Chinese. The term is now also used in the Contract Law and the franchise regulations to mean "good faith."

The Contract Law, like the section on obligations in the BGB or German Civil Code, has provisions mandating "good faith" during negotiations. Article 42 provides as follows:

> 第四十二条　当事人在订立合同过程中有下列情形之一，给对方造成损失的，应当承担损害赔偿责任：
>
> （一）假借订立合同，恶意进行磋商；
>
> （二）故意隐瞒与订立合同有关的重要事实或者提供虚假情况；
>
> （三）有其他违背诚实信用原则的行为.
>
> (Article 42 In the making of a contract, the party that falls under any of the following circumstances, causing thus loss to the other party, shall hold the liability for the loss.

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[32] 委托合同 (Weituo Hetong), better described as "agency agreements," Chapter 21.

[33] 行纪合同 (Xingji Hetong), Chapter 22.

[34] 居间合同 (Jujian Hetong) Chapter 23.

[35] *Supra* note 18.

[36] Translation form the bilingual edition of 中华人民共和国民法通则 – *General Principles of the Civil Law of the People's Republic of China* / 中华人民共和国民事诉讼法 – *Civil Procedure Law of the People's Republic of China*, published by Law Press, Beijing, China, 1999.

(1) engaging in consultation with malicious intention in name of making a contract;

(2) concealing intentionally key facts related to the making of a contract;

(3) taking any other act contrary to the principle of good faith.)[37]

This provision essentially requires that parties negotiating a contract conduct themselves in good faith and according to principles of fair dealing. The phrase "重要事实" (zhongyao shishi) is here translated as "key facts," but is more commonly translated as "material facts."

This provision is based on the civil law doctrine of *culpa in contrahendo* (or "fault in negotiating")[38] as first developed by Rudolf von Jhering[39] and that was later added to Germany's BGB in 2002 by amendments to Articles 241(2) and 311.

In Germany and Québec such provisions have been used by judges in franchise disputes to impose a pre-sale duty of disclosure on the franchisor, notwithstanding the absence of franchise disclosure laws. In China's civil law system the implications of this provision for franchise matters is now expanded upon in the franchise regulations and measures.

Article 60 of the Contract Law also provides that the parties shall fulfill their obligations under the contract in good faith.

The Contract Law provides that with certain specific exceptions the parties to a foreign-related contract are free to choose the applicable law.[40]

a. Agency Contracts - 委托合同

[37] Translation from the bilingual edition of *Contract Law of the People's Republic of China (Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999)* published by Law Press, Beijing, China, 1999.

[38] 韩世远 (Han Shiyuan), "我国合同法中的缔约上过失问题研究 (*Wo Guo Hetong Fa Zhongde Diyue Shang Guo Shi Wenti Yanjiu – Study of Liability for Fault in Negotiating in Our Country's Contract Law*), 3 法学家 (FAXUE JIA - JURIST) 2004.

[39] The doctrine was first expounded in "Culpa in Contrahendo, oder Schadenersatz bei nichtigen oder nicht zur Perfektion gelangten Verträgen" (Culpa in Contrahendo or Damages for Void or Unperfected Contracts), in 4 *Jahrbücher Für Die Dogmatik Des Heutigen Römaischen Und Deutschen Privatrechets* [Yearbooks of the Dogmatics of the Modern Roman and German Private Law] 1(1861). Friedrich Kessler and Edith Fine, Culpa in Contrahendo, Bargaining in Good Faith, and Freedom to Contract: A Comparative Study , 77 *Harvard Law Review* 401, at pp. 401-9 (1964) as cited in E. Allen Farnsworth , Duties of Good Faith and Fair Dealing under the Unidroit Principles, Relevant International Conventions, and National Laws, Universität Köln, available online at http://tldb.uni-koeln.de/php/pub_show_document.php?pubdocid=122100 .

[40] Article 126.

As mentioned above these have a special chapter (Chapter 21) in the Contract Law, and are also known as “Entrustment Contracts” in some Chinese translations of the law. The concept is considered by some to be analogous to the concept of “mandataire” in European civil law jurisdictions. The agent (受托人 – shou tuo ren) is specifically authorized to handle the affairs of the principal (委托人 – wei tuo ren).

Article 398 of the Contract law requires that the principal pay the agent in advance for such services. An example is the relationship between a patent agent and its client.[41] The agent may delegate the services, and can bind the principal with respect to third parties if the third party is aware of the agency relationship. Article 410 provides that the either party may dissolve the relationship at any time, but if the termination causes loss to the other party, compensation is payable.

b. Brokerage Contracts - 行纪合同

Brokerage contracts are dealt with in Chapter 22 of the Contract Law. In this type of contract the agent is also described as an “intermediary” (行纪人 – xingji ren – middleman) or “commissionaire,” and it undertakes business in its own name (Article 414). Here the expenses incurred in handling the affair are to be borne by the intermediary unless the parties stipulate otherwise.

Article 423 provides that for matters not dealt with in Chapter 22 the provisions of Chapter 21 on agents shall apply. As a matter of interpretation, if the issues are still not dealt with in Chapter 21 the general provisions of the Contract Law would apply.

c. Intermediation Contracts - 居间合同

In this type of arrangement described in Chapter 23, the intermediary reports to the principal and takes specific instructions. Some consider this type to be similar to the European concept of “courtier.” If this type of agent contributes to the making of the contract, the principal is required to reward it.

d. Franchise Agreements – 特许经营合同

[41] 徐耀忠诉上海浦一知识产权代理有限公司 (Xu Yaozhong v. Shanghai Pu Intellectual Property Agency Co., Ltd.), Shanghai No. 1 Intermediate People’s Court, （2009）沪一中民五（知）初字第 174 号, December 24, 2009.

Franchise agreements are not specifically described in the Contract law and are therefore governed by the general provisions of the law, and specific regulations administered by the Ministry of Commerce.[42]

2. Other Transactional Laws

a. Intellectual Property Laws

China has also adopted a full set of intellectual property laws and has continued to update and amend them, seeking comments from foreign organizations in the process.[43] Although many enterprises in China's "Wild West" economy have yet to learn to respect these intellectual property laws, the Chinese courts have made considerable effort to both understand and enforce the intellectual property laws. Most major courts now have specialized intellectual property benches for such cases and many courts are now posting their decisions online.[44] Chinese courts do enforce intellectual property rights.

With respect to trademarks China is a first-to-file jurisdiction, although the currently proposed amendments to the Trademark Law would provide some limited rights based on use in China. Because of the backlog of applications at the Trademarks Office was taking approximately three years for a registration to issue on a straightforward application, but there are signs that the

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[42] The most recent ones were came into force on May 1, 2007. They are 商业特许经营管理条例 – Shangye Texujingying Guanli Tiaoli, Ordinance No. 485 adopted on January 31, 2007 at 167th Regular Meeting of the State Council, in effect from May 1, 2007; 商业特许经营备案管理办法 – Shangye Texujingying Bei'an Guanli Banfa (Commercial Franchise Registration Administrative Measures) Decree No. 15 of 2007, adopted at the 6th Inter-Departmental Meeting[42] of the Ministry of Commerce on April 6, 2007, and came into force as of May 1, 2007; 商业特许经营信息披露管理办法 – Shangye Texujingying Xinxi Pilu Guanli Banfa (Commercial Franchise Information Disclosure Administrative Measures), Decree No. 16 of 2007 adopted at the 6th Inter-Departmental Meeting of the Ministry of Commerce on April 6, 2007, and came into force as of May 1, 2007.

[43] These include the Patent Law, *Zhonghua Renmin Gongheguo Zhuanli Fa* ("Zhuanli Fa"), adopted at the 4th Session of the Standing Committee of the 6th National People's Congress on March 12, 1984 and amended in 1992 and 2000 (proposed amendments prepared in consultation with foreign organizations such as the American Bar Association Intellectual Property Section are now before the State Council for consideration); the Copyright Law, *Zhonghua Renmin Gongheguo Zhuzuoquan Fa* ("Zhuzuoquan Fa"), adopted at the 15th Session of the Standing Committee of the 7th National People's Congress on September 7, 1990 and amended in 2001; the Trademark Law *Zhonghua Renmin Gongheguo Shangbiao Fa* ("Shangbiao Fa"), adopted at the 24th Session of the Standing Committee of the 5th National People's Congress on August 23, 1982, as amended in 1993 and 2001 (proposed amendments are now being circulated for discussion); and the Anti-Unfair Competition Law, *Zhonghua Renmin Gongheguo Fan Bu Zhengdang Jingzheng Fa* ("Fan Bu Zhengdang Jingzheng Fa") adopted at the 3rd Session of the Standing Committee of the 8th National People's Congress on Spetember 2, 1993 and effective as of December 1, 1993.

[44] The Supreme People's Court has a section of its web site devoted to IPR decisions at: http://ipr.chinacourt.org/ ; the Beijing Court system has a special page at: http://bjgy.chinacourt.org/cpws/?LocationID=0901020000 ; decisions from Jiangsu Province may be found at: http://www.jsfy.gov.cn/cps/site/jsfy/ ; Zhejiang Province posts its decisions at: http://www.zjcourt.cn/portal/ ; and Guangzhou City posts its decisions at: http://www.gzcourt.org.cn/ .

pendency is shortening quickly. It is thus important to file trademark applications in China well before the planned entry.

It is also important to file a Chinese character version of the brand. The Chinese language has a structure that is dramatically different from most other languages, including Japanese and Korean. This leads to some trademark issues that are unique to China. Firstly Chinese uses a very restricted range of sounds, limited to about 400 syllables. With the four tones found in Mandarin, there are about 1300 sounds available to represent approximately 10,000 words. In other words the only unique representation that a word has in Chinese is its associated Chinese character. A particular syllable may have a dozen or so meanings, which in spoken Chinese must be determined from the context.

Learning Chinese therefore requires a focus on memorizing the characters. Linguists researching language acquisition are now finding that written Chinese is processed in an area of the brain close to the motor-skills control area, whereas reading English is handled near the area that processes listening.[45] When Chinese speakers, even fluently bilingual speakers, are presented with signs in both Chinese characters and English, it is significantly more likely that the Chinese will be retained and remembered, and that the English will be forgotten.

Further because a precise phonetic correlation between the English word mark and the available Chinese syllables is rare, if Chinese speakers are presented with a mark that is only in English, they usually will invent a Chinese "nickname" for the mark using Chinese syllables. The interesting issue what characters and meanings will be used to represent the sounds. There are usually significant differences in the choices available.

For these reasons any business wishing to control the use of its brand in China should ensure that it controls the "nickname" that arises by developing and registering a Chinese version of its mark.

b. Leasing and Property Law

Land in China is owned by the state. But since at least 1988 Chinese law has recognized that private parties may have a fungible right to use such land. Generally known as "granted land use rights" they have been granted for between 40 to 70 years. [46] At this point renewal issues have not yet arisen. State-owned enterprises were also allocated land for their purposes that was not supposed to be transferable.

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[45] Li Hai Tan, John A. Spinks, Guinevere F. Eden, Charles A. Perfetti and Wai Ting Siok, *Reading Depends on Writing, in Chinese*, PROCEEDINGS OF THE NATIONAL ACADEMY OF SCIENCES 2005; 102; 8781-8785; see also Katherine Forestier and Florence Lui, *Linguists crack puzzle of Chinese and English*, SOUTH CHINA MORNING POST, Online Edition, Wednesday, June 8, 2005.

[46] Patrick A. Randolph Jr., *The New Chinese Basic Law of Property: A Real Estate Practitioner's Perspective,* unpublished manuscript, 2008.

The new Property Rights Law[47] now refers to granted land rights as the "Right of Use in Land for Construction"[48] under the civil law concept of usufructuary rights. The holder of this interest in the land has the right to transfer or mortgage the interest.

Leases are a nominate form of contract in the Contract Law and non-financial leases are governed by Articles 212 to 236 of the Contract Law.[49] Leases may not be longer than 20 years [50] and if longer than six months must be in writing. Subleases are permitted with consent and changes in ownership do not invalidate a lease.

There are no specific provisions regarding the remedies for breach of a lease, meaning that the parties must rely upon the general provisions in the Contract Law. These do not contain any self-help remedies such as repossession.

c. Competition Law

China's new Anti-Monopoly Law[51] will come into effect on August 1, 2008. The law sets out the general principles of what constitutes anti-competitive conduct. It is considered to be "mainstream" in its provisions.[52] It will need regulations and guidelines to properly enforce it, and they are slowly emerging, but primarily with respect to mergers and acquisitions so far.

Distributors should monitor developments with respect to Chapter II on Monopoly Agreements. There are separate sections on horizontal and vertical agreements. The primary prohibition with respect to vertical agreements is with respect to resale price maintenance.[53] There is also an

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[47] *Supra* note 20.

[48]建设用地使用权 –Jianshe Yongdi Shiyong Quan, see Articles 135-151 of the Property Rights Law.

[49] 租赁合同 – Zulin Hetong – Chapter 13.

[50] Article 214.

[51]中华人民共和国反垄断法 (Zhonghua Renmin Gongheguo Fan Longduan Fa), Presidential Decree No. 68, adopted at the 29th Session of the Standing Committee of the 10th National Peoples Congress and promulgated on August 30, 2007 to come into effect August 1, 2008.

[52] Lisl Dunlop, *Interview with William Blumenthal, General Counsel, Federal Trade Commission*, 7(2) THE ANTITRUST SOURCE, December 2007; available online at: http://www.abanet.org/antitrust/at-source/07/12/Dec07-Blumenthal12-17.pdf . Similar sentiments were also expressed in William Blumenthal ; Stuart Chemtob (Special Counsel, International Trade, Department of Justice, Antitrust Division); Paul Jones and Jun Wei (Hogan & Hartson LLP, Beijing), "Understanding the New Antitrust Law in China: Implications for U.S. Companies and Investors," Teleconference Program presented by Strafford Publications, Atlanta, Georgia, October 25, 2007.

[53] Articles 14(1) and (2).

exemption provision that includes agreements "for the purpose of boosting operational efficiency and enhancing the competitiveness of small and medium sized undertakings."[54]

Prior to the implementation of the AML there were a number of press reports about the practice of foreign automobile manufacturers to set resale prices for their dealers.[55] And within a week of the implementation of the law there were press reports that Toyota and Ford had in fact issued notices to dealers emphasizing that they were free to set their own prices.[56]

Finally in Article 55 of the AML it is stated that the AML is applicable to conduct that eliminates or restricts competition by abusing intellectual property rights. An "abuse of intellectual property rights" is not defined in the AML and it is anticipated that it will be a long time before there is a regulation to assist in the interpretation of this provision.[57]

1. Taxation

As China's economy has grown, it has also become less dependent of foreign investment. Previously the tax laws had given incentives to foreign investment. In 2007 the National People's Congress adopted the Enterprise Income Tax Law[58] which removed most of the incentives previously provided.

Article 3 of the new tax law provides that businesses without a permanent establishment in China shall pay tax on income derived from within China. For foreign distributors this means that some payments such as royalties from their Chinese agents are subject to taxation by the Chinese authorities. These payments are thus subject to the withholding tax provisions of Article 37. The rate is 10% and whether a credit is available in the supplier's home country depends on the tax treaties with China, and whether the supplier owes taxes in its home jurisdiction.

In the technology transfer sectors, such as engineering, Chinese tax authorities are now questioning many allocations of payments to services when the allocation to royalties is low or

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[54] Article 15(3).

[55] 《反垄断法》8 月 1 日起实施 棒喝汽车行业潜规则 (The Implementation of the "Anti-Monopoly Law on August 1st will Shout Stop to the Hidden Rules of the Automotive Industry), 今日早报 (Today's Morning Post), 2008-07-16, available online at: http://auto.fivip.com/law/200807/16-156955.html .

[56] 反垄断法冲击车市潜规则 配套规则亟待出台 (Implementation of the Anti-Monopoly Law has an Impact on the Hidden Rules of the Automotive Sector: Regulations or Guidelines are Needed), 中国财经报 (China Financial Reports), 2008-08-06, available online at: http://www.chinanews.com.cn/it/dzsw/news/2008/08-06/1337705.shtml .

[57] For more extensive discussion of this issue see: Paul Jones, "Licensing in China: The New Anti-Monopoly Law, The Abuse of IP Rights and Trade Tensions," XLIII (2) *les Nouvelles: Journal of the Licensing Executives Society International* 106 (June, 2008).

[58] 中华人民共和国企业所得税法 – Zhongguo Renmin Gongheguo Qiye Suodeshui Fa, adopted at the 5th Sessionof the 10th NPC on March 16, 2007 and in effect from January 1, 2008.

nil. Such challenges are not unique to China, and are part of a larger debate with respect to the intellectual property rights regime in developing countries. Suppliers should consider using gross-up clauses with respect to withholding taxes, or being prepared to justify in detail the charges for services or goods provided.

Either way there does need to be a distribution agreement or license agreement signed and registered to facilitate to payment of the funds in a foreign currency.

2. Currency Controls and Remittances

Despite American pressure the Chinese currency, known as the "renminbi" or "yuan" is still not freely exchangeable, although controls have loosened over the last decade and the reasons for the controls have changed. Currently the yuan is significantly undervalued with respect to the American dollar but China is trying to let its value rise slowly, presumably to cushion the impact of the rise on manufacturers and to control inflation.[59] The controls are administered by the State Administration of Foreign Exchange.[60]

In order to be allowed to purchase the relevant foreign currency for payments outside the country the payor must submit documents evidencing the requirement to make the payment out side the country to a bank.

3. Dispute Resolution

Although Article 268 of the Civil Procedure Law[61] provides for the enforcement of foreign judgments in China, it does so on the basis of reciprocity, and there is no treaty between China and the U.S. and most other countries on the reciprocal enforcement of judgments. Thus a U.S. court judgment cannot be enforced in China.

China is however a party to the New York Convention on the Enforcement of Arbitral Awards and the norm in international agreements is to use arbitration. Article 267 of the Civil Procedure Law provides for the enforcement of arbitration awards. Chinese parties tend prefer arbitration through CIETAC,[62] in China, but foreign parties are often choosing Hong Kong, Singapore or even Stockholm.

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[59] *China to tighten currency controls,* SYDNEY MORNING HERALD, July 8, 2008.

[60] In Chinese 国家外汇管理局 – Guojia Waihui Guanli Ju. The English language web site is at: http://www.safe.gov.cn/model_safe_en/index.jsp .

[61] *Supra* note 24.

[62] China International Economic and Trade Arbitration Commission. Web site is at: http://www.cietac.org/.

Chinese courts have applied foreign law, namely that of Hong Kong, when the parties have made such choice in the agreement, provided that the parties largely agree on the provisions of the foreign law. Where there is disagreement about the foreign law in such circumstances the judges tend to apply Chinese law.

Litigation in China is generally faster and less expensive than in the U.S. There is no discovery and each party is responsible for their own evidence, although a request can be made to the judge to require the other party to produce specific evidence. This is typical of civil law systems.

Российская Федерация

THE RUSSIAN FEDERATION

I. Introduction

The Russian Federation arose out of the dissolution of the Soviet Union in 1991. It was the largest of the republics that made up the Soviet Union, and at 142,008,838[63] it is still the ninth largest country in the world by population. Russian is still one of the world's major languages as it is widely spoken in the former republics of the Soviet Union and is still an official language in the former Soviet Republics of Belarus, Kazakhstan and Kyrgyzstan. It is estimated to be the fifth most commonly spoken language in the world with over 250 million speakers.[64] There are recent claims as well that Russia's population is starting to grow again after several years of steady decline.

After the economic difficulties of the 1990's the Russian economy has recovered significantly. In 2007 real GDP increased by 8.1%,[65] the highest percentage increase since the fall of the Soviet Union. The ruble has achieved some stability and inflation has been moderated. Russia's GDP per head of $9,059 USD[66] makes it the richest per capita of the BRIC countries. Its economy is considered to be the 11th largest in the world with a nominal GDP value of $1,289,582 million

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[63] As of January 1, 2008, Федеральная Служба Государственной Статистики (Federal Service for State Statistics) online at: http://www.gks.ru/free_doc/2008/demo/popul08.htm .

[64] G. Weber, *Top Languages,* 3 LANGUAGE MONTHLY 12 (1997).

[65] *Russia's GDP growth reached 8.1% in 2007 – statistics service,* RIA NOVOSTI, 31-01-2008, online at: http://en.rian.ru/russia/20080131/98116820.html .

[66] *Country Briefings – Russia: Factsheet,* ECONOMIST.COM, April 29, 2008, (market exchange rate, but $14,662.00 USD on the basis of purchasing power parity) online at: http://www.economist.com/Countries/Russia/profile.cfm?folder=Profile-FactSheet .

USD.[67] These factors have led to an increased interest in Russia recently as a country to invest in.

A recent report in the Wall Street Journal noted that the top-performing funds of the last decade invested primarily in Russian equities.[68] The story notes that "At the moment, Russia is still under-owned and undervalued in relation with its peers …investors panic-sold in the fourth quarter of 2008 and are only now slowly returning."

Politically Russia is a federal presidential republic with a two chamber legislature whose members are elected in multi-party elections. The lower house or Duma is the more powerful body as all proposed laws must first be considered by the Duma. The new constitution[69] arising out of the 1993 "constitutional crisis" provides for a strong presidency. The President has broad authority to issue decrees and directives that have the force of law without legislative review, although the constitution notes that they must not contravene that document or other laws. The main political party, Единая Россия (Yedinaya Rossiya or United Russia) was founded in 2001 as the vehicle for the election of Vladimir Putin as President.

II. Legal Structure and System

As its name suggests Russia is organized as a federal state. On its founding there were 89 subject units in six classes: 49 oblasts; 1 autonomous oblast; 6 krais (or territories); 21 republics (including Chechnya) 2 federal cities; and 10 autonomous okrugs or districts, although now there are only 83. These were units created by the old Soviet Union with little thought for the significance of their boundaries. For this and other reasons using these as a basis for a federal structure was considered by many to be unstable and the source of some of Russia's problems. Certainly this structure was an impediment to the implementation of the rule of law. Some local administrations were noted for their corruption.

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[67] International Monetary Fund, World Economic Outlook Database., as at April 2008 (for the year 2007), at http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx.

[68] Ira Iosebashvili, "Decade's Top-Performing Funds Focused on Russia," WALL STREET JOURNAL, December 29, 2009, available online at: http://online.wsj.com/article/SB10001424052748703278604574623981022618934.html .

[69] КОНСТИУЦИЯ РОССИЙСКОЙ ФЕДЕРАЦИИ – Constitution of the Russian Federation, adopted by a national vote on December 12, 1993. It came into force on publication on December 25, 1993. Available online in English at: http://www.constitution.ru/en/10003000-01.htm .

One of Vladimir Putin's reforms as President was to decrease the power of these units and the governors in part by grouping the units into seven federal districts (федера́льные округа́ - federalnyye okruga*)*, each administered by an envoy appointed by the President. These envoys are responsible for seeing that the units comply with federal laws and policies. This was part of a larger program to reassert federal authority that has led to Putin being criticized as an authoritarian outside Russia but having the confidence of 84% of Russians that he was doing the right things in world affairs.[70]

The 1993 Constitution[71] establishes a division of powers. Article 71 sets out exclusively federal powers such as civil procedure for the courts and intellectual property. Article 72 sets out powers that are jointly held by both the federal government and the units of the federation, such as the use and management of land, education and cultural matters. Article 73 allocates powers that do not fall into either of these two categories to the federal units.[72] Distributors will be primarily concerned with federal laws.

Prior to the 1917 Revolution Russia had a legal system influenced primarily by continental Europe's civil law system. After the 1917 Revolution Lenin ordered that a civil code based on western European civil law be prepared. The system of Soviet law that later developed was built on a civil law structure.

Today the Russian Federation is a civil law jurisdiction. With assistance from scholars at the University of Leiden in the Netherlands a new civil code was prepared and adopted in parts by the Duma from 1994 to 2006. The most recent provisions, Part IV on intellectual property, came into effect January 1, 2008. In structure the Civil Code or Гражданский Кодекс[73] (Grazhdanskii Kodeks) more closely resembles the German civil code than the French. The Civil Code has many familiar principles such as equality before the law, protection of private property, freedom of contract, and the free exercise and judicial protection of civil rights.

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[70] Erin Carriere-Kretschmer and Kathleen Holzwart, *Putin's Popularity Propels Chosen Successor in Russian Election: Russians Prefer Strength in their Leader, Economy over Democracy,* PEW RESEARCH CENTER PUBLICATIONS, February 27, 2008, online at: http://pewresearch.org/pubs/749/russia-public-opinion .

[71] *Supra* note 69.

[72] For further discussion see Marat Salikov, *The Russian Federal System: Sub-National and Local Levels*, CONFERENCE ON SUBNATIONAL CONSTITUTIONS AND FEDERALISM: DESIGN & REFORM, Rutgers University Center for State Constitutional Studies, March 22-27, 2004, available online at: http://camlaw.rutgers.edu/statecon/subpapers/salikov.pdf .

[73] An English translation of the first three parts is available online at: http://www.russian-civil-code.com/ . A Russian version of all four parts is available at: http://www.gk-rf.ru/ .

For distributors the Civil Code is an important document because it contains not just the section on contracts and other obligations[74] but because it also contains Chapters 51 on Commission Agency[75]; Chapter 52 on Agency[76] and Chapter 54 on what are known as “Commercial Concessions” or franchises.[77] And now Part IV contains provisions on the licensing of intellectual property, including trademarks, which must also be considered in structuring a sales agency or distributorship. These will be discussed later.

The Russian court system is generally based on the civil law model but the civil courts are divided into two types. The general court system handles civil matters for individuals, such as family law matters, criminal matters and administrative matters. The final appeal court for this system is the Supreme Court of the Russian Federation.[78] There is a separate court system for commercial matters known as the “Arbitrazh” courts supervised by the Supreme Arbitrazh Court.[79] These should not be confused with the arbitration process, which operates quite separately.

While in civil law systems there is no doctrine of precedent and decided cases can be used in court for their persuasive value only, there is an advantage in civil law systems, particularly in transitional economies, to having ready access to court decisions. If nothing else they are guides as to the interpretations of the judges.

A weakness of the Russian court system is that it is currently difficult to obtain copies of cases. For example it is sometimes said that there is only one reported franchise case,[80] known as the

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[74] Раздел 3. Общая часть обязательного права (Section 3, General Part on the Law of Obligations).

[75] Глава 51. Комиссия.

[76] Глава 52. Агентирование.

[77] Глава 54, Коммерческая Концессия (Kommercheskaya Kontsessiya).

[78] Верховный Суд Российской Федерации, web site at: http://www.supcourt.ru/mainpage.php .

[79] Высший Арбитражный Суд Российской Федерации, web site with limited explanations of the system in English at: http://www.arbitr.ru/ .

[80] According to the web site of Ассоциация Франчайзинга, The Russian Franchise Association at: http://www.rarf.ru/content/document_r_D29A514D-25E8-4446-BF44-13857743EB3A.html .

Wokie Dokie case. It is the subject of a practice commentary posted on the web site of the 10th Arbitrazh Court of Appeals,[81] but the actual decision is unavailable to the public.

The Russian Government has recognized this as a problem and on December 22, 2008 a law was adopted to require internet access to the courts and their decisions by July 1, 2010.[82] The information was to be posted on the internet and the goal of the reform was to make the courts more transparent, increase trust in them and decrease the opportunities for corruption. Work is progressing steadily on this project and the access to cases is improving.

Russia has one of the world's highest rates of imprisonment[83] and the court system in Russia is not highly trusted. Security issues and corruption should be major considerations for any franchisor considering doing business in Russia. On the other hand the new Russian President, Dmitry Medvedev, has declared in his initial speeches that the court system must be reformed to prevent bribery and corruption, and to make the courts truly independent.[84]

III Laws of General Application

1. Contract Law

As in other civil law jurisdictions the basic principles of Russia's contract law are set out in the Civil Code, primarily in Part on Obligations.[85] Sales agency, distribution and franchise agreements must conform to these general provisions as well as the special provisions in their specific chapters of the Civil Code.

Consideration is not necessary for the formation of a contract. The making of a contract requires only an offer, an acceptance, a meeting of the minds on the significant conditions, in compliance with the requisite form. Article 161 requires that contracts with juridical persons (e.g. corporations) must be in writing. Also as in other civil law systems, third party beneficiaries of a

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[81] Особенности правового регулирования договора коммерческой концессии (франчайзинга) (Special Features of the Legal Regulation of Commercial Concession Agreements (Franchising) available (in Russian) at: http://10aas.arbitr.ru/index?tid=633200051&nd=458200049 .

[82] Об обеспечении доступа к информации о деятельности судов в Российской Федерации (On Access to the Actions of the Courts of the Russian Federation), № 262-ФЗ, Decemebr 22, 2008; available on line at: http://www.kadis.ru/texts/index.phtml?id=32605 .

[83] Yakov Gilinsky, *Crime in Contemporary Russia,* 3(3) EUROPEAN JOURNAL OF CRIMINOLOGY 259 (July 2006).

[84] *President Medvedev calls for independent courts to end corruption,* RIA NOVOSTI 20-05-2008, at: http://en.rian.ru/russia/20080520/107883956.html .

[85] Раздел 3. Общая часть обязательного права (Section 3, General Part on the Law of Obligations).

contract have a right to the enforcement of the benefits allocated to them under certain conditions (see Article 430).

The general provisions on Contract have an Article[86] that specifically deals with what are called “Предварительный договор” or “Preliminary Contracts” or what could also be called “letters-of intent.” This Article provides that the parties are obliged to conclude another contract in the future that will contain the final conditions. The period in which the final contract shall be completed shall be specified in the preliminary contract. If they are not specified the final contract must be completed within one year from the date that preliminary contract was entered into.[87]

In designing a sales system for Russia, distributors should take into account the provisions of Article 431 on the interpretation of contracts. If the literal meaning cannot be established from the words and the ambiguity cannot be resolved by comparisons with other conditions and with the overall sense of a contract, the intent of the parties may be determined by taking into account the purpose of the contract. In doing so the court may take into account the negotiations preceding the contract and correspondence, practice established by the mutual relations of the parties, custom, and the subsequent conduct of the parties. These provisions would override any "entire agreement" or "no waiver clauses".

Article 10, in the general provisions at the beginning of the Civil Code presents special problems for contract formation in Russia that cannot be readily resolved. It reads:

> Article 10. Limits on the Exercise of Civil Rights
>
> 1. Not admissible shall be actions by the citizens and the legal entities, performed with the express purpose of inflicting damage to another person, as well as the abuse of the civil rights in other forms. Not admissible shall also be the use of the civil rights for the purpose of restricting the competition, as well as the abuse of the dominating position on the market.
>
> 2. In case of the person not abiding by the requirements, stipulated in Item 1 of the present Article, the court of justice, the arbitration court or the arbitration tribunal shall have the right to reject this person's claim for the protection of the right he possesses.
>
> 3. In the cases when the law makes the protection of the civil rights dependent

[86] Статья 429, Глава 27. Понятие и условия договора (Article 29, Chapter 27 – Concept and Conditions of Contract).

[87] ЗАО Северфинанс v. ЗАО "СИМПЛ (JSC Severfinans v. JSC Simpl), Federal Arbitrazh Court of the Moscow District, Дело N A40-68233/09-77-465, December 30, 2009, available online at: http://www.klerk.ru/doc/171485/.

on whether these rights have been exercised in wisdom and honesty, the wisdom of actions and the honesty of the participants in the civil legal relations shall be presumed.[88]

This is the Russian equivalent of the civil law doctrine of abuse of rights,[89] and would appear to be the basis for concepts such as the rescission of contracts for “delusion” or fraud in Articles 178 and 179. While the meaning and the scope of the provision is still being determined, recently Russian courts have increased their use of it, applying it in cases concerning interest rates on loans, foreign currency clauses in commodity contracts, and contractual penalties.[90] This Article is often pleaded in case nothing else works, as it gives significant scope for judicial discretion.

There are also provisions in the Civil Code that may be considered to play the role of the good faith doctrine during the term of a contract. Article 309 of the general provisions on obligations requires that obligations be performed " ... duly in accordance with the conditions of the obligation ... and in the absence of such conditions and requirements, in accordance with business custom ...” A commentator[91] has described this provision as requiring that contracts be performed in good faith and in the proper manner, which appears to be an expansion upon the Russian phrase “надлежащим образом (nadlezhashchim obrazom),” which may be translated as "duly" or "properly" or literally as "... in the appropriate manner."

However other articles also allow for the intervention of the courts to set relationship standards. Article 428 defines a contract of adhesion or accession as one whose conditions have been determined by one of the parties in formulas and other standard forms and may be accepted by the other party by no other way than to accede to the proposed contract in its entirety.

Section 2 of Article 428 provides that a party to such a contract has the right to demand dissolution or change to the contract even if the contract otherwise complies with the law, if the contract deprives the party of rights usually granted under contracts of that type, excludes or limits the responsibility of the offer or for a violation of an obligation, or contains other conditions clearly burdensome for the adhering party which the adhering party would not have accepted if it had the opportunity to participate in determining the conditions of the contract.

Section 3 of Article 428 provides that a party to a contract of adhesion shall not obtain the remedies mentioned if they knew or should have known the conditions on which the contract had been concluded.

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[88] Translation from http://www.russian-civil-code.com/ .

[89] Ekaterina Sjöstrand, *Abuse of Rights under Russian Law,* 4(2) RUSSIA/EURASIA COMMITTEE NEWSLETTER 7 (Fall 2007) (ABA International Section).

[90] *Ibid.* at 9.

[91] Christopher Osakwe, *Anatomy of the 1994 Civil Codes of Russia and Kazakstan: A Biopsy of the Economic Constitutions of two post Soviet Republics*, 73 NOTRE DAME LAW REVIEW 1413 (1998).

Part Three of the Civil Code contains detailed provisions on international private law in Part VI. Articles 1186 - 1194, for example provide the circumstances under which a foreign law may be applicable in the Russian Federation. While there a "public order" exception to the application of foreign law, Article 1193 describes its application as "exceptional."

Recently a Russian Arbitrazh Court recognized and enforced the judgment of a court in the Netherlands, even though there is no treaty between the two countries for the reciprocal enforcement of judgments.[92] This is considered by some to be the first exercise of comity by a Russian court.

Article 1210(1) provides that parties may select the governing law for a contract. This can even be done retroactively, and can be done for part or all of the contract. Thus a distributor could choose to have the grant of the right to use the trademark governed by Russian law and have the remainder governed by the law of its home jurisdiction. Article 1211 provides a set of default rules where there is no agreement by the parties on the applicable law. In Article 1211(3)(16) the law with respect to "Commercial Concessions" or franchises is specified to be that of the franchisor.

a. Contract of Commission – Поручение[93]

Article 971 of the Civil Code defines this type of relationship as one where the agent is obliged to act in the name of and at the expense of the principal as determined in the contract. Such contracts may be indeterminate. The principal is obliged to issue a power of attorney to the agent for the performance of legal actions.

Both parties have the right to terminate the Agreement (Article 977) but liability for such termination is set out in Article 978. If the principal terminates the contract before it has been "performed" by the agent the principal is liable for the agent's costs and remuneration commensurate with the work done.

b. Action's in Another's Interest without Commission - Действия в чужом интересе без поручения[94]

In this type of relationship the agent takes the initiative and performs the actions before receiving a retainer and instructions. Obviously the actions must be then ratified by the principal.

c. Commission Agency - Комиссия[95]

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[92] Подъемные технологии (Lifting Technology) v. Rentpool B.V., Высшего Арбитражного Суда (Supreme Arbitrazh Court), Определение от 7 декабря 2009 г.(Decision of December 7, 2009) N ВАС-13688/09; available online in Russian at: http://www.consultant.ru/online/base/?req=doc;base=ARB;n=131210 .

[93] Chapter 49 of the Civil Code.

[94] Chapter 50 of the Civil Code.

In this type of relationship the agent is obliged to conclude a transaction in its own name, but at the expense of the principal. The agent must conclude the transactions on the terms that are most advantageous for the principal. The contract may be terminated by the principal at any time but the agent has the right to compensation for losses. The principal must give not less than 30 days notice of the termination unless the parties have agreed to a longer notice. The agent has similar rights to terminate the contract.

d. Agency - Агентирование[96]

This is a further type of agency arrangement that is similar to the relationships of Contract of Commission or Commission Agency. In fact the provisions of Chapter 49 or 51 may also apply to this relationship in the absence of specific provisions in this Chapter. There is no notice period for termination provided for in this Chapter.

e. Commercial Concessions - Коммерческая концессия[97]

Although the concept of "commercial concession" is often translated as "franchise" the concept is defined in Article 1027 as requiring:

1. grant of a right to use in business
2. for remuneration
3. a complex of exclusive rights, including trademarks and protected commercial information.

This definition is broader than the more common definitions in U.S. law in that there is no requirement for assistance or control in the operation of the business. Thus some distributorships may also be determined to be governed by this Chapter.

However these contracts must be in written form, and must be registered with Rospatent.[98] Failure to comply with these provisions will result in the contract being considered void (see for

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[95] Chapter 51 of the Civil Code.
[96] Chapter 52 of the Civil Code.

[97] Chapter 54 of the Civil Code.

[98] Article 1028. The Rospatent regulations for registration of commercial concession agreements are contained in the "Административный регламент по регистрации договоров о предоставлении права" (Administrative Regulations for the Registration of Contracts Granting Certain Rights), приказом Министерства образования и науки РФ от 29 октября 2008 г. N 321 (Order of the Ministry of Education and Science of October 29, 2008 No. 321) available online at: http://www1.fips.ru/wps/wcm/connect/content_ru/ru/documents/russian_laws/administrative_regulations/test_9/index_page .

example the Wokie Dokie case mentioned earlier). The grantor is obliged to transfer technical and commercial information and to provide permanent technical and consultative assistance. The grantor is also obliged to control the quality of the goods or services.

Article 1032 contains the obligations of the grantee, all of which are mandatory. One of the important themes of the Chapter on Commercial Concessions is the protection of consumers,[99] and in this regard grantees are required to inform their customers that the trademark and other commercial designations are used under a franchise agreement. The grantee is obliges to use identity of the grantor and to ensure the conformity of the equality of the goods or services and to comply with the instructions of the grantor in this regard.

The grantor is responsible to consumers for defects in the goods and services and is liable jointly and severally with the grantee for such defects.[100] This liability is similar to the liability of licensors under Article 1489 of the new part IV of the Civil Code.

Grantees also have a right to renew on the same conditions, and either party may terminate without notice unless a notice period is specified in the contract.

The grantor may only refuse to renew the commercial concession agreement if it does not plan enter into a similar agreement for the same territory for three years. If the grantor does wish to enter into such an agreement, the grantor must offer the former grantee a right of first refusal or compensation.[101]

Article 1037 contains the provisions regarding termination. Art. 1037(1) allows either party to terminate the franchise agreement at any time on six months prior notice, unless the agreement species an earlier notification period.

2. Other Transactional Laws

a. Intellectual Property Laws

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[99] Corinna M. Wissels, *The Russian Civil Code: Will It Boost or Bust Franchising in Russia?,* 22(5) REVIEW OF CENTRAL AND EAST EUROPEAN LAW 455-479 (1996); also available in the CCH Business Franchise Guide at ¶7352.

[100] Article 1034.

[101] According to Dr. Juliana Tabastajewa, *Russian Franchise Law – Statutory Provisions and Current Case Law,* 3(3) INTERNATIONAL JOURNAL OF FRANCHISNG LAW 3 (2005) at 12, in 2003 a franchisee sued for renewal but was denied such renewal by the Arbitrazh Court because the franchisor had not offered the franchise to anyone else.

As mentioned earlier, as of January 1, 2008 Russia's separate laws on trademarks, copyrights, patents and other types of intellectual property were replaced[102] with the new Part IV of the Civil Code.[103] This was a controversial move and the implications are still being determined. One of the advantages of having these laws as part of the Civil Code rather than as separate statutes is that the provisions of the Civil Code are considered more important than individual statutes.

The general view is that the scope of the trademark rights has not changed substantially.[104] In Russia rights to a trademark are acquired by registration and not by use, and that has not changed. The provisions on trademarks are now Articles 1477 to 1514 of the Civil Code. Articles 1489 to 1491 contain the provisions on the licensing of trademarks.

Previously a draft of Part IV had required the licensor to supervise the quality of the goods produced by the licensee. Now Article 1489(2) only requires that the licensor ensure the compliance of the licensee's goods to the quality standard prescribed. However the Licensor and the licensee are held jointly liable for the quality of the goods with respect to third parties.

One of the major changes introduced by the new Part IV is the concept of a "commercial name."[105] Commercial (and certain non-commercial) organizations are allowed to use one such name. The concept is much the same as a "business style name" or "dba." It can be used to identify the company but need not be the same as the formal name on the incorporation documents of the company. Article 1539(5) provides that the owner of a commercial name can grant a right to use such name under certain circumstances, including under Article 1027, commercial concession (franchise) agreements.

An issue frequently faced by distributors is whether it is necessary to register and use their trademarks in both the Latin alphabet and in the Cyrillic alphabet. Russian is a Slavonic language and part of the Indo-European family of languages. It is closely related to many of the languages of Central and Eastern Europe. These languages are written either in Latin script or Cyrillic depending upon the whether the population predominantly adheres to the Roman Catholic or Eastern Orthodox Church.

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[102] О введении в действие части четвертой Гражданского кодекса Российской Федерации – On the Introduction of Part IV of the Civil Code of the Russian Federation, approved by the State Duma on November 24, 2006, published in the Russian Gazette on December 22, 2006, Federal Law No. 231 FZ.

[103] Federal Law No. 230-FZ of December 18, 2006.

[104] Pavel Sadovsky, *Part IV of the Civil Code: A Mixed Blessing,* AEB BUSINESS QUARTERLY, No. 4, 2007, available online at: http://www.magisters.com/publication.php?592/articles/ .

[105] Articles 1538 to 1541.

Russians are thus very familiar with the pronunciation of the Latin alphabet. In 2007 the Russian Chamber of Patent Disputes decided that a trademark registered in the Latin alphabet, but used in Russia on packaging only in the Cyrillic alphabet, was in fact being used in Russia. The variation in the alphabets did not alter the distinguishing character of the trademark.[106]

Still the prudent course of conduct is to register both Cyrillic and Latin alphabet versions. Some words do not convert as clearly as others and the ruling in each particular case will depend on the degree of similarity in the two versions.

b. Leasing and Property Law

Land is still a sensitive issue in Russia. Land reform was one of the major demands of the 1917 revolution. Although the basic provisions regarding the ownership of property and the leasing of it are dealt with in the Civil Code, there were still concerns about the rights to land. In 2001 the Duma adopted the Land Code.[107] It still does not apply to agricultural land, but it does apply to urban land where most sales outlets will be situated.

The Land Code gives the owners of buildings the right to purchase the underlying land from the appropriate government and establishes formulas to calculate the price.[108] It also provides that with some exceptions foreign individuals and legal entities are to receive the same treatment as Russians. Foreigners are specifically permitted to lease land.

Otherwise Section II of Part I, "The Right of Ownership and Other Rights of Estate,"[109] of the Civil Code contains the general provisions on the rights of ownership of property, such as the components of the right of ownership.[110] A "lease" is a nominate form of obligation or contract and the general sections on obligations[111] apply to them in so far as they are not specifically varied by the provisions of Chapter 34 of Part II of the Civil Code on leases.[112]

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[106] Vladimir Biriulin, *Chamber rules on use of mark in Cyrillic,* MANAGING INTELLECTUAL PROPERTY, July 2007.

[107] Земельный кодекс Российской Федерации of October 25, 2001, Federal Law No. 136 – FZ.

[108] Oganes Sarsikov and Geoffrey Cleasby, RUSSIA'S NEW LAND CODE, U.S. Foreign Commercial Service and U.S. Department of State, 2002, available online at: http://www.russianamericanchamber.org/newsletter/russianewlandcode.htm .

[109] Раздел II. Право собственности и другие вещные права.

[110] Article 209.

[111] Раздел 3. Общая часть обязательного права (Section 3, General Part on the Law of Obligations).

[112] Глава 34. Аренда, Articles 606 to 670.

Lessees have a pre-emptive right to renew a lease upon expiry unless otherwise provided in the law or in the lease agreement.[113] A lease can be terminated for breach on application to a court by either party.[114] There is no right to repossession as exists in common law.

c. Competition Law

Although Russia adopted a competition laws in the 1990's,[115] in 2006 a revised and more comprehensive law was adopted.[116] In came into effect on October 26, 2006. The Russian Federal Anti-Monopoly Service[117] (FAS) has become very active over the two years. In 2008 it handled 6,540 cases of which 2,978[118] or 45% were against the so-called "administrative monopolies" such as state-owned enterprises, municipal governments and even ministries of the federal government.

Since Dmitri Medvedev became President and Vladimir Putin assumed the ostensibly lesser role of Premier in March 2008 the priorities for reform have changed. Medvedev in particular wants an increase in the role of the private sector in the economy. It appears that he is not alone, and Putin has been responsible for implementing some of the changes by giving strong support to FAS.

Since the submission of the "*Report on the State of Competition in the Russian Federation*"[119] June of 2008 and the demand by Prime Minister Putin to the FAS to "wake-up," FAS has been very active recently in many ways.

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[113] Article 621.

[114] Articles 619 and 620.

[115] RSFSR of March 22, 1991 № 948-I «On Competition and Limitation of Monopolistic Activity in Commodity Markets» and the Federal Law of June 23, 1999 № 117-FZ «On Protection of Competition in the Market of Financial Services».

[116] О защите конкуренции – On the Protection of Competition, adopted 26.07.2006 as Federal Law No. 135 FZ.

[117] In Russian the Федеральная антимонопольная служба, web site: http://www.fas.gov.ru/ .

[118] FAS Press Release, Игорь Артемьев представил доклад «О состоянии конкуренции в Российской Федерации» (Igor Armetiev presented the report "On the Status of Competition in the Russian Federation") July 14, 2009, available online at: http://www.fas.gov.ru/news/n_25348.shtml.

[119] Доклад о состоянии конкуренции в Российской Федерации, submitted to the Government in June, 2008; released publically October 31, 2008; and available in Russian at http://www.fas.gov.ru/competition/goods/20916.shtml .

In 2009 the Duma adoptd what is known as the "Second Anti-Monopoly Package" consisting of amendments to the law *On the Protection of Competition*, the *Code of Administrative Violations of the Russian Federation*, and the *Criminal Code*.[120]

The FAS had sought many of the amendments to clarify its authority to bring actions, particularly with respect to cartels. Highlights of the amendments include:

- The law *On the Protection of Competition* was expanded to clarify that it covered not only agreements abut also actions.

- The definition of "a group of persons" was expanded.

- The concepts of "monopolistically high" and "monopolistically low" prices were clarified by having defined by both the cost method and the comparable markets method.

- The legislative threshold of 35% of a market necessary to hold a dominant position was weakened in favor of assessments of actual control.

- The prohibitions on vertical agreements previously in Article 11(1) were revoked. These included prohibitions on territorial, scope or sales restrictions. Exclusive conditions are now not expressly prohibited. However this has been replaced by a *Resolution on the Instances of Admissibility of Agreements between Economic Entities*.[121]

- The thresholds for notifiable transactions were increased.

- The right of FAS to conduct investigations was broadened.

- A limitation period for violations was introduced.

- Fines were increased and the leniency program was tightened.

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[120] Второй антимонопольный пакет, available online in Russian at: http://www.fas.gov.ru/competition/20349.shtml .

[121] О Случаях допустимости Соглашений Между Хозяйствующими Субъектами, Постановление от 16 июля 2009 г. Но. 583, Government of the Russian Federation; available online in Russian at: http://www.kadis.ru/texts/index.phtml?id=38362 .

- Criminal penalties were added, particularly for cartels.

It should be noted that in Russia re-sale price maintenance cases are frequently brought by the FAS and even “recommended prices” are prohibited.

d. Taxation

One of the factors leading to the decline of the Soviet Union was diminished tax revenues from state-owned enterprises. Tax avoidance has been part of Russia’s problems as well. So many tax reform initiatives have been introduced to deal with this that the reforms and constant changes have contributed to the perception of an unstable tax system. [122]

One of Vladimir Putin’s major reforms was to adopt flat tax rates for Russia. The corporate income tax rate is now 24%, where as previously it was 35%. This has led to an increase in collections. However structuring investments for tax avoidance is still a significant part of many Russian franchise deals. It is common to set up an entity in Cyprus to eliminate or reduce the withholding taxes on royalties remitted from Russia.

[122] Galina G. Preobragenskaya and Robert McGee, *A Comparative Study of Taxation in Russia and Other CIS, East European and OECD Countries,* Andreas School of Business Working Paper Series, Barry University, April 2004.