

International Report

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Subject: International Developments

To: Franchise Law Committee

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Copies: None

Kazakhstan – Enactment of Franchise Law

Effective June 24, 2002, (but only recently reported in unofficial translated form in this country) Kazakhstan has joined the growing number of countries with laws regulating franchising with the adoption of the Law on Complex Business License (Franchising.)

Kazakhstan's new law is, if not unique, certainly distinct from that of a number of other countries.

Among other things, the law does not expressly impose pre-sale UFOC-type disclosure, or registration, obligations (although there is a section regarding the Franchisor providing information on the rights to be transferred to the Franchisee if an agreement is signed) and is limited to relationship and related issues.

In addition, unlike the laws in North America and other areas, significant portions of the law enhance and protect the interests of Franchisors, arguably providing as much protection to Franchisors as to Franchisees.



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Finally, the law will apparently apply both to the award by foreign companies of rights to all of Kazakhstan (e.g. the grant of area or subfranchise rights), as well as to awards of franchises by a Kazakhstan-based subfranchisor covering individual operating units.

Let's review some of the details:

- The law begins by setting out admirable principles of state support, including “inadmissibility of wrongful interference by state authorities and officials with the business activity of the parties to franchising relations” and “transparency of the process of developing and applying measures of state support to franchising relations.”

While actual administration of any nation's laws is the ultimate test of their efficacy, the philosophical approach embedded in Kazakhstan's law (including a provision for the state paying damages in the event of unlawful acts by the state or its officials!) is refreshing.

- The law provides for the registration of the rights of the Franchisor, presumably covering the intellectual property which is the subject of the franchise. How this provision will be integrated with existing Kazakhstan laws and treaties in the area of trademarks, copyrights, etc. remains to be seen.
- Language in the law, which remains to be clarified, seems to imply that the Franchisor shall provide “a complex of exclusive rights” to the franchisee. Exclusivity is, of course, often a point of contention in franchising and we shall have to see how the law is interpreted in this regard.
- The Franchisor is clearly given rights to control the quality of goods and services provided by the Franchisee, terminate the franchise for defaults by the Franchisee and to purchase if the Franchisee attempts to sell his/her company.
- The Franchisor has an obligation to (among other things) provide training and not disclose confidential information obtained from the Franchisee.

- The Franchisee is obligated to:
 - use the franchise in the manner indicated in the franchise agreement,
 - provide access and information to the Franchisor so as to allow the Franchisor to exercise control over the use by the Franchisee of the rights licensed,
 - comply with instructions of the Franchisor regarding those rights,
 - not disclose confidential information,
 - not participate in competitive activities,
 - make timely payments,
 - cure defaults,
 - not transfer rights in violation of the franchise agreement and
 - inform customers about use of the trademark as specified in the franchise agreement.
- Finally, accounting records “of entities engaged in franchising activities” are to be kept pursuant to Kazakhstan laws on accounting and financial records, a requirement that will be interesting (!) to interpret, since none of us have any knowledge whether this requirement applies to a U.S.-based Franchisor doing business or awarding franchises in Kazakhstan or of how Kazakhstan practice compares to U.S. GAAP!

From a business standpoint, then, the new franchise law in Kazakhstan does not generally appear to impose any insurmountable obstacles to franchising and, in fact, may be more helpful than the laws of many other countries.

Korea – Presidential Decree re Franchise Disclosures

Like other countries, Korea has in place (and has had since November 1, 2003) a law regulating both franchise disclosure and relationships.

While some of the items to be included in the disclosure document provided to prospective Franchisees were specified under the Korean law and a Presidential Decree of June 13, 2003, significant additional detail was provided by the release of a Schedule to the Presidential Decree, released on November 6, 2003.

Some of the specific disclosure items now required under the Korean law, and related unanswered questions) include:

- Name and address of the Franchisor and “specially-related parties, including controlling shareholders!
- Domestic business office address.
- Information regarding marks.
- Prior fiscal year’s balance sheet and income statement.
- Biographies of officers (but not directors?)
- Similar businesses operated by the Franchisor in the last five years (anywhere in the world and even under different marks?)
- List of intellectual property licensed to the Franchisee (note that this is **not** limited to the marks and could include other system elements.)
- List of orders and convictions, including any “breach of trust,” even if not related to the franchised business.
- Start-up and ongoing costs (unclear if this is limited to amounts paid to the Franchisor and any affiliates.)
- Information regarding designated suppliers.

- Territorial restrictions.
- “Standard” terms of the Franchise Agreement.
- UFOC Item 20-type information.
- Explanation of procedures, processes and timetable for commencement of the franchised business.

Once again, this type of regulation highlights the need for Franchisors to work with experienced international franchising counsel in formulating country- and deal-specific disclosures and not relying merely on providing a copy of the domestic UFOC to prospects.

As always, if you need further information or assistance regarding any of these matters, please don't hesitate to contact any of the international franchise law attorneys with our firm.