COMPARATIVE ANALYSIS OF FRANCHISING
IN THE RUSSIAN FEDERATION AND CANADA

by

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This thesis compares franchising regulation in the Russian Federation with that of Canada. In order to be the most profitable, and function in the most efficient way, franchising must be properly regulated. Russia is currently experiencing a stagnation of franchising. This is partly because of the inefficient and outdated nature of the legislation that governs franchise relations in the country. In comparison, franchising business is flourishing in Canada. Canadian franchising legislation, reinforced by Canadian case law, represents a more developed system of regulation. The goal of this study is to reveal the strengths of Canadian franchising regulation as well as the weaknesses of Russian franchising regulation. This thesis also suggests ways to improve Russian franchising law and practice.
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Introduction

Today franchising constitutes a significant part of the world’s economy. Such significance is attributable to the benefits that this form of organization provides to both small, and well established, businesses. Established companies benefit from the ability to expand their business in a timely fashion and they can do so without incurring significant costs. This is because franchised outlets do not require as much time and investment as those that are company-owned since many are financed solely by franchisees. Small companies realize many benefits from franchising. First, they receive the franchisor’s assistance in setting up the business and do not need to start from scratch. Second, they do not need to identify their clientele as this has already been done by the franchisor. Finally, the overall stability of newly created franchise outlets further promotes the popularity of franchising. A large number of companies engaged in franchising can have a significant positive effect on a country’s economy. The influence of franchising is especially significant today, as many businesses are expanding internationally.

Franchising is widely used throughout the world and its benefits for national economies are substantial. However, franchising relations in Russia are poorly developed. The undeveloped state of franchising in the country is partly explained by the absence of a sophisticated system of franchising legislation. The main source of legislation that governs business in Russia is the Civil Code of the Russian Federation (Civil Code). The Civil Code contains only fourteen sections that regulate franchising. These sections are of a very broad and general nature. This makes them ineffective in facilitating the establishment and development of complex franchise relations. The Civil Code does not provide parties with adequate instruments for the protection of their interests. The most detrimental effect on franchisees comes from the absence of the obligation of pre-franchise disclosure of information. However, ineffective franchise legislation is not the only reason for the current
state of franchising in Russia. Also problematic is the fact that Russia remains a developing country. Thus, parties to a contract are often faced not only with corruption issues, but also with underdeveloped legal and judicial systems. These factors together can have a significant effect on any business ventures, and they deter many foreign investors from entering the Russian market.

Developed countries, by contrast, have more elaborate systems of franchising regulation. Many of these countries have separate laws that only deal with franchising. In the United States, a country with one of the most developed franchising markets in the world, the disclosure of information by the franchisor is regulated by a special federal law.\(^1\) Moreover, many states have adopted additional laws that regulate franchising to an even greater extent. Because of the significance of franchising, developed countries keep this business system in a constant state of evolution. Evolution is driven by mechanisms such as research, annual franchising conferences, and franchising forums. In common law jurisdictions the franchising system is constantly updated as cases are decided and additions are made to an already extensive jurisprudence. These practices can be employed by Russian theorists to facilitate the development of franchising in Russia. To achieve better results these practices should be adapted to the specifics of the Russian environment. This adaptation would take place during the process of legal transplantation, one of the main instruments of legal evolution. The use of already developed concepts will aid the Russian government in the creation of effective franchising governance. Effective franchising regulation is needed if Russia is to achieve extensive growth of franchise businesses.

Russia currently enjoys high rates of economic growth and a rapidly expanding domestic market. The primary reasoning behind the creation of a contemporary system of franchising

\(^1\) FTC Franchise Rule 16 C.F.R. Part 436 “Disclosure Requirements and Prohibitions Concerning Franchising”.
regulation is that it will help maintain this extensive growth while providing high quality services to the Russian people. The wealth of the population is growing, and with it the demand for goods and services of higher quality. Amid ongoing political change many internationally accepted legal instruments are being introduced into the Russian legal system. Further, a significant number of foreign companies have established businesses in the country, and many investors are seeking to enter the Russian market. The prospect of foreign investment has encouraged the Russian authorities to be more considerate of the needs of the international business community. Despite the complications involved in conducting business in the country, foreign businesses continue to enter and operate in the Russian market. Additionally, international companies operating in Russia are able to use their investments as a significant source of leverage when confronting the problems which are prevalent in the country. The above factors indicate that there is the potential for substantial gains to those businesses that decide to begin operating in the Russian market. To further facilitate the growth of business in the country, particularly in the franchise market, the Russian government needs to undertake a major reform of the part of its legal system that relates to franchise relationships.

This thesis seeks to aid in such a reform. Russian legal research that compares and analyzes the legislation of foreign jurisdictions is limited. This thesis can serve as an initial step in such an endeavor. Legal research can play an important role in the development of a country’s legal system. It can analyze existing legal instruments and facilitate the creation of new ones, promote further research, and be used by judges as guidance in deciding cases. This research project will compare the franchise legislation of one North American jurisdiction (Ontario) with that of Russia, and will propose amendments to Russian law. This research will analyze the practical application of certain elements of North American franchising regulation and highlight possible complications with that regulation. It will also
cover the use of other common law concepts as they affect franchise businesses. Further, a preliminary overview of how such elements can be employed in Russia will be provided. In addition to the legislative analysis the project will describe the current investment environment in Russia. This section will cover the major complications that investors may face in the Russian market.

The research will proceed as follows. In Chapter One theoretical concepts of franchising will be outlined. Franchising will be compared to other similar arrangements, and the main distinctive elements of franchising will be established. Chapter Two will analyze the obligation of the franchisor to disclose information in Ontario. This chapter also discusses common problems present in the Ontario franchise legislation, and provides an analysis of the possible reasons for these problems. Additionally, this section includes some possible solutions to the problems it highlights. Chapter Three will suggest how several specific elements of Ontario franchise legislation can be transferred to Russia. The final chapter, Chapter Four, will describe the current Russian business environment. This provides a background of the environment in which foreign investors may establish their business, and provides an overview of possible problems they may face. This Chapter will discuss issues such as the current legal system, the prevalence of corruption, and the judicial system of Russia. Finally, this Chapter will analyze the effect that these factors have on franchising and propose possible solutions to these problems.

**Chapter One: Theoretical Framework of Franchising**

In general terms franchising can be defined as a system of relations between two parties under which one party (the franchisor) grants another (the franchisee) an object of intellectual property (often a trade-mark). This object of intellectual property is granted to
the franchisee to use to render specific services, and/or sell specific goods, to the public. Depending on the type of franchising chosen by the parties the franchise relationship can have additional characteristics. The main types of franchised businesses are: (i) distributorship, (ii) business opportunities, and (iii) business format franchising.² Under a distributorship the franchisee is licensed to sell certain products and/or services, in a specific territory, under the franchisor’s trademark. In this type of arrangement the franchisee develops a business system on its own and can exercise broad discretion in respect to the operation of the franchise, while the franchisor’s participation is mainly limited to the provision of a trademark.³ Under business opportunities franchising, the franchisor provides the franchisee with the right to sell goods or services, and provides location assistance. Location assistance can be in the form of securing retail outlets or accounts for the goods or services.⁴ Business format franchising is widely considered the most sophisticated and precisely structured type of franchising. This thesis focuses on analyzing business format franchising since this type of franchising possesses the most conspicuous characteristics of a franchise relationship. Business format franchising implies the use of the whole of the franchisor’s already developed business system. Additionally, the franchisee has access to the franchisor’s trademark, know-how, marketing strategies, and standards. Further, the franchisee is expected to act in accordance with a detailed operations manual.

Franchising presents an alternative expansion method to vertical integration. One of the main reasons that companies choose franchising over vertical integration is rooted in agency theory. This theory seeks to describe an optimal arrangement for ensuring an agent’s maximum performance in a situation where the principal cannot accurately evaluate the

agent’s performance, and where both of them have different risk tolerances. Franchising addresses some of the main problems that arise from this situation. These problems are moral hazard (uncertainty as to whether agents are putting in their best efforts) and adverse selection (the difficulty in ascertaining true quality of an agent’s performance). Normally, to deal with these problems the principal is required to either monitor the agent’s performance and pay the costs associated with doing so, or to provide the agent with a residual claim to the profits of the business. Since monitoring is costly, especially if the business is geographically wide-spread, principals often resort to making agents residual claimants. In contrast to a manager, the franchisee has a direct incentive to put maximum effort into a franchise since the quality of effort directly influences franchisee’s profits. Further, a franchisor does not bear the following additional costs: buying or leasing the premises, maintenance of the premises, and paying employee salaries. There are also a number of other factors that influence the decision of a company to use franchising instead of establishing company-owned outlets. These factors include, inter alia, the geographical dispersion of the business, the rates of growth of the business, or the size of the royalty rates paid by franchisees.

Franchising also has a number of inherent problems. The main problem is that franchising creates incentives for the franchisee to free-ride on the efforts of others. This problem is the

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result of misaligned interests between the franchisor and the franchisee. One way in which franchisees free-ride is by chiseling on the quality of product.\textsuperscript{13} Further, the incentive to shirk rises as the royalty rate increases.\textsuperscript{14} While franchisees fully benefit from their under-investment in the business, they bear costs that are proportionate to their share in the system. This gives them a greater incentive to engage in shirking.\textsuperscript{15} Such free-riding negatively affects the whole franchise system. Thus, the franchisor is required to monitor the quality and performance of franchised outlets. To maintain an acceptable level of quality and performance the franchisor can establish company-owned outlets that operate alongside franchised outlets. This allows the franchisor to more carefully monitor all of the outlets in the system.\textsuperscript{16} Chiseling on the quality by franchisees undermines the value of the brand and reduces the franchisor’s profits from company-owned outlets.\textsuperscript{17} The existence of company-owned outlets also diminishes the franchisees’ risk that franchisors may refrain from promoting the chain’s brand name.\textsuperscript{18} In the end, franchising is a trade-off that allows companies to achieve a balance between different agency problems.\textsuperscript{19}

The Main Distinctive Features of Franchising

In order for potential franchisors and franchisees to better understand the institution of franchising it is useful to highlight its main features. Understanding its distinctive features helps the parties in their assessment of the potential risks and ramifications of their involvement in franchising. It also helps the parties to structure their relationship in the most efficient and profitable way. A clear understanding of the main features of a franchise helps

\textsuperscript{13} Shane, \textit{supra} note 5 at 719.
\textsuperscript{16} Lafontaine, \textit{supra} note 11 pp. 263-283.
\textsuperscript{17} Scott, \textit{supra} note 13 at 71.
\textsuperscript{18} Benjamin Klein & Lester Saft, “The Law and Economics of Franchise Tying Contracts” (1985) 28 J.L. & Econ. 345 at 360.
\textsuperscript{19} Brickley & Dark, \textit{supra} note 14 at 420.
to distinguish it from other similar contractual relations. This knowledge can also help legal scholars and legislatures draft efficient laws regulating franchising. Additionally, the elements of the franchising relations that are highlighted will be used to compare franchising regulation in the Russian Federation to that of Canada.

One of the key elements of franchising is an object of intellectual property belonging to the franchisor. Examples of this object include a trademark, trade name, or commercial symbol. In the context of franchising this object of intellectual property is generally referred to as the “trademark”. The essential element of a franchise is the permission to use a well-known trademark. A well known trademark achieves a wider recognition by the public of the franchised business. This increases the franchisee’s chances of success. The trademark is granted to the franchisee for a fee on the basis of a license agreement that extensively regulates the conditions of the trademark’s use. Along with the trademark the franchisor often grants to the franchisee the entire business system. This often includes know-how, techniques, methods of operation and other important information pertaining to the operation of a franchise. Since in an established franchise relationship the franchisee is given all of the necessary information and techniques regarding operation of the franchise, and bears the costs of operating an outlet, the licensing of a well-known trademark is a very cost-effective method of business expansion for the franchisor.

The use of a trademark makes franchising similar to licensing relations. Nevertheless, the two types of relationships differ greatly in some respects. A license is a right of one party to use an object of intellectual property belonging to another party. The main distinction between a license and a franchise is that under a licensor-licensee relationship the licensor has much less control over the licensee and its operations. In a franchising relationship the

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franchisor’s control over the franchisee’s business is relatively extensive.\textsuperscript{21} Control is imposed on the franchisee in order to maintain a relative uniformity of operations and to uphold a minimum standard of service.\textsuperscript{22} In addition, under a franchise, many more objects of intellectual property are often granted to the franchisee.

The notion of control is also one of the elements that make some franchising relations resemble employment relations. However, the regulation of employment relations is very different. In a franchise the franchisor has a certain degree of control of the franchisee. This high amount of control has led some theorists to say that “the definition of the franchisee as a separate firm, rather than as a part of the franchisor, is a legal and not an economic distinction”.\textsuperscript{23} There are various tests that are used to differentiate employment relations from other relations. The common law control test states that employment relations exist when a person for whom the services are performed has the right to control both the result of the work and how this work is done.\textsuperscript{24} Considering the development of modern contract law “there is no universal test to determine” employment relations, but “the level of control … over the worker's activities will always be a factor”.\textsuperscript{25} Since employment relations are regulated in a unique way courts often look for a number of additional criteria when trying to distinguish employment relations from other relations. Examples of these additional criteria include arrangements between the two parties in respect of ownership of tools, and integration into the business.\textsuperscript{26} Neither Canadian franchise legislation, nor the Uniform Law Conference of Canada Uniform Franchises Act, as of the writing of the present work, defines

\begin{footnotesize}
\begin{enumerate}
\item Rubin, supra note 9 at 225.
\item Regina v. Walker, (1858) 27 L.J.M.C. 207 at 208 in Glickman, supra note 21, ibid. at 2-49.
\end{enumerate}
\end{footnotesize}
employment relations. Further, neither suggests how to identify such relations. In this situation common law tests are helpful. Additionally, some insight can be gained from the Federal Trade Commission (FTC) Compliance Guide to the Franchise Rule 16 C.F.R. Part 436, May 2008 (Franchise Rule Compliance Guide). This document explains in great detail the application of the FTC Franchise Rule 16 C.F.R. Part 436 “Disclosure Requirements and Prohibitions Concerning Franchising” in the United States, a federal act that regulates the process of disclosure in the United States. This document states that the control test would initially be applied to determine if an employment relationship exists. Besides the factor of control, other factors like payment of definite sums of money for the work, the ability of the principal to terminate relations, and financial investment on behalf of a person before commitment of his/her work would be closely considered.27

The comparison of a franchise with employment shows that the franchisor cannot exercise the same degree of control over the franchisee as an employer over the employee. A franchisee’s autonomy (contrary to an employee’s autonomy) has a number of aspects. Many business decisions are made by the franchisee alone. A franchisee operates a franchise on its own, receives profit that depends on how well a franchise is operated, often buys and operates franchise premises, and hires its own employees. These factors illustrate that the franchisee has significant autonomy in the relationship.28 A franchise allows the exercise of a certain amount of entrepreneurial qualities by the franchisee. This is one of the main reasons franchising is so prevalent.

Despite the fact that a franchisee is permitted to make certain decisions on its own, it often cannot exercise discretion in an unfettered fashion. While the franchisee’s autonomy is greater than that of an employee, it is less than that of an independent entrepreneur. The

27 Franchise Rule Compliance Guide at 15.
28 Frank Mathewson & Ralph A. Winter, “The Economics of Franchise Contracts” (1985) 28:3 J.L. & Econ. 503 at 503.
franchisor permits the franchisee almost full use of its trademark and business system. As such, the franchisor seeks to ensure that this system (and the reputation of the franchise) is not damaged or changed during operation by the franchisee. In order to preserve the system there are a number of factors put in place to constrain a franchisee’s discretion. The main limiting factors are the franchise agreement and the franchisor’s business manual. Both of these thoroughly regulate most aspects of the franchise operation.

Additionally, the autonomy of the franchisee is constrained by the ability of the franchisor to dictate the conditions of the franchise agreement. The franchisor’s ability to dictate the terms of the franchise agreement could also be said to be a distinctive identifying feature of franchising. While terms and conditions of most contracts are negotiable, franchising contract negotiations are dominated by the “take it or leave it” principle. Even though a franchisee can shop around and select a franchise from a different franchisor, every franchisor tries to preserve the consistency of its business system. This results in the imposition of stringent rules. Since most franchisors take measures to protect their business system, franchisees may have difficulty in finding a profitable franchise with flexible requirements. The franchisor is the more powerful party and can dictate most conditions to a franchisee. Such conditions include: the range of products sold, business hours, quality standards, appearance of the premises, range of suppliers, leasing conditions, as well as conditions limiting the franchisee’s competition with the franchisor. It could be argued that the imposition of stringent rules is also in the franchisee’s interests and that franchisees willingly accept them. Stringent rules ensure consistency throughout the business system. Consistency leads to better maintenance of the value of the trademark and stops from chiseling on the quality by all franchisees. In the end, as long as stringent conditions contribute to the profitability of the franchise system franchisees will willingly accept such conditions. Generally, abusing franchisees’ interests would not be beneficial to the
franchisor since such actions undermine the whole business system. However, since the
franchisor has extensive powers there is no guarantee that it will not abuse them. This can
lead to a number of possible negative implications. A franchisor’s abusive actions can
damage the franchisee, suppliers, and customers or lead to the restriction of competition.

The rights and obligations of the parties constitute an important part of franchising. These
rights and characteristics also help to differentiate franchise agreements from other contracts.
Rights and obligations are the most important components of any contractual relationship
and any contract comes with its own unique set of rights and obligations. In developed
countries the most important requirement for the creation of an efficient franchise practice is
the obligation of a franchisor to disclose certain information to the franchisee before entering
into a franchise agreement. Franchising involves a contract between two parties with
unequal bargaining powers. The franchisor is usually a well-established legal entity with
substantial financial resources. On the other hand, the franchisee is often a small entity that
lacks significant business experience and information about the franchisor, and about the
franchise being offered. In order to address the problem of asymmetric information
developed legal systems impose disclosure obligations on franchisors before they enter into a
franchise agreement. These obligations help to protect potential franchisees. These
obligations also respond to the widespread misrepresentations and deceptive practices
employed by franchisors before the legislative introduction of such obligations.29

For the most part franchising legislation in Canada and the United States regulates disclosure
requirements. This legislation requires the franchisor to provide certain information to the
franchisee before entering into the franchise agreement. Such information may include
details about the business, operations, capital, management responsible for the franchise and

29 FTC Franchise Rule 16 C.F.R. Parts 436 and 437 “Disclosure Requirements and Prohibitions Concerning
Franchising and Business Opportunities”; Final Rule at part I.A.
financial statements. The release of this information helps the franchisee to “make a properly informed decision about whether or not to invest in a franchise”. Further, franchising contemplates many other significant rights and obligations along with those associated with the disclosure of information. Such rights and obligations include the provision of training or payment of advertising fees. Additionally, the duty of good faith and the right of franchisees to associate play a significant role in Canadian franchise practice.

Comparing franchising with other similar contractual relationships reveals additional unique characteristics of the franchising relationship. Comparing a franchise with a joint venture illustrates that franchising is an arrangement between separate parties with distinct interests. Under franchising the parties do not exercise joint control over the business, they do not have joint proprietary interests in the subject matter, and they do not share losses. Additionally, the main object of the franchise agreement, a trademark, is owned solely by the franchisor. This helps to distinguish a franchise contract from a lease arrangement. The lessee does not use the trademark belonging to the lessor, but rather uses its own trademark in operating its business on leased premises. Similarly, the independence of the parties in a franchising agreement forms the basis for distinguishing franchises from partnerships.

Franchising also possesses many characteristics of an incomplete contract. One of the franchisor’s main goals is to protect its business system. Because the franchisor has such extensive powers to impose contractual terms on the franchisees, many provisions of the franchise agreement regarding the franchisor’s powers can be quite broad. Additionally, the franchise agreement cannot reasonably regulate all aspects of a franchised business. The franchise system is also constantly under development by the franchisor. Some provisions

30 E.g. s. 5(4) of the Ontario Act.
31 1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd. (2005), 256 D.L.R. (4th) 451 at para. 16 [Dig This Garden].
32 Glickman, supra note 21 at 2-91.
of the franchise agreement can be quite broad in order to facilitate such development.

Franchise contracts can be regarded as incomplete contracts because they often do not contain specific provisions justifying certain actions by the franchisor, or regulating certain aspects of the franchisee’s behavior.33

**Legal Definitions of a Franchise**

Many of the above highlighted characteristics of franchising are reflected in legal definitions of a franchise. Specific elements of the definition, such as the criterion of payment or the use of a trademark, differ across jurisdictions. Federal franchising legislation in the United States uses only several of such elements to define what constitutes a franchise. This definition includes: (i) a franchisor’s promise to provide a trademark or other commercial symbol, (ii) its promise to exercise significant control over or provide significant assistance to the franchisee’s method of operation, and (iii) a minimum payment by the franchisee of at least $500 during the first six months of operations.34 Other jurisdictions define a franchise in much broader terms. In Ontario, the definition of a franchise in the Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3. (Ontario Act) lists many more criteria of a franchise than just the main elements. The definition states the elements that relations must possess in order to be regarded as franchise relations, and such elements are very broad. Not only are all three types of franchising mentioned above covered, but some other contractual non-franchise arrangements can inadvertently fall under the scope of this definition as well. The broad criteria used in the definition of a franchise in the Ontario Act include, *inter alia*, a criterion of payment by the franchisee, which covers any payment associated with business

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34 16 C.F.R. Parts 436 and 437 “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities”; Final Rule at § 436.1; Franchise Rule Compliance Guide at 11.
operations, and a criterion of exercise of significant control or assistance. At the same time, there is no guidance as to the meaning of significant control or assistance.\textsuperscript{35}

The importance of the legal definition of franchising becomes very acute in jurisdictions where meeting the criteria of a franchise leads to consequences like mandatory disclosure obligations. Because of the wide definition of a franchise in the Ontario Act, simple product distribution and dealer relationships may fall under its coverage.\textsuperscript{36} This would mean that the principal party in those relations would have to comply with mandatory disclosure obligations. A wide scope for franchise legislation tends to be viewed positively from the consumer protection point of view, and particularly positively by small franchisees. The downside of such a broad scope is that it can burden relations among more sophisticated actors who do not need such extensive protection.\textsuperscript{37} Additionally, some statutes such as the Ontario Act explicitly prohibit contracting out of the jurisdiction. This can complicate relations between parties even more since they cannot select the optimal legal rules to govern their relationship.\textsuperscript{38} Because franchise legislation contains such particularities, parties should be well aware of them beforehand. Further, parties should approach the process of negotiations professionally in order to build efficient relations and to avoid unnecessary complications. This approach is especially relevant in case a master franchise is granted.

It is clear that franchising, like any other contract, has a number of its own distinct features. Features, such as the licensing of a trademark, disclosure requirements, or strict adherence to a business manual, help to identify franchising and distinguish it from other contracts. This is particularly helpful when dealing with those contracts that share similar characteristics or elements with franchising contracts. In the next chapter, these features will be analyzed in

\textsuperscript{35} Liisa Kaarid & Peter Viitre, “Franchise Law for Occasional Practitioner” (Paper presented on the OBA 5\textsuperscript{th} Annual Franchise Conference, September, 2005) at 26 [unpublished].
\textsuperscript{36} Zaid, \textit{supra} note 1 at 41.
\textsuperscript{37} Kaarid & Viitre, \textit{supra} note 34 at 25.
\textsuperscript{38} S. 10 of the Ontario Act.
greater detail and will be used to compare franchising regulation in the Russian Federation to that in Canada.

Chapter Two: Regulation of Disclosure Obligations

One of the main characteristics of franchising regulation in developed countries is the imposition of disclosure obligations on the franchisor before the sale of a franchise. The franchisor is required to provide to a potential franchisee certain information that will allow the latter to make a more informed decision in respect of buying a franchise. The disclosure document usually contains information about the franchisor, relevant financial information, the obligations of the parties, as well as a number of other items. This information will help the franchisee to better understand the nature of the commitment. Failure to provide a disclosure document or disclosure of incorrect information may lead to adverse consequences for the franchisor such as rescission of the franchise agreement or claims for damages. Such consequences make mandatory disclosure a useful instrument in deterring the potential violations of franchisees’ interests that can arise as a result of asymmetric information between the franchisor and the franchisee.

Russian legislation does not impose disclosure obligations on the franchisor. This is a major gap in Russian franchising legislation. This gap negatively affects the whole franchise practice in the country. Franchisees are forced to buy a franchise without fully understanding the nature, and possible ramifications, of the deal. This situation is especially unfavorable for small franchisees. Due to their relative inexperience franchisees are unable to properly assess an offered franchise on the basis of publicly available information. It is a costly and lengthy process for the franchisor to provide a disclosure document. As such, it is unlikely that franchisors in Russia would be willing to voluntarily disclose a substantial
amount of sensitive information. There are also a number of other deficiencies in the Russian legal system. These deficiencies include: the small number of effective remedies and indemnities available to contracting parties, and the complexity, and outdated nature, of the legal system. These deficiencies, coupled with the absence of disclosure obligations, create a potential for significant violations of the parties’ interests. They are also major obstacles for the successful development of franchising in the country. Currently the implementation of disclosure obligations in franchising is of the utmost importance for the Russian legislature. The experience of other countries can be very beneficial for this project. Canadian franchise legislation, for example, can function as a useful model for legal transplantation. With some changes and adaptation to Russian practices, Canadian legislation can be implemented in the Russian legal system.

**Regulation of Disclosure Obligations in Ontario**

Franchising in Canada is regulated not at the federal level but at the level of the provinces. The analysis undertaken in this work will concentrate on the legislation and practice of Ontario. This province was chosen because it enjoys the highest level of business activity in the country. The Ontario Act, together with the Regulation made under the Arthur Wishart Act (Franchise Disclosure), 2000 (O.REG 581/000 amended by O.REG 611/00; O.REG 69/41; O.REG. 199/05) (Ontario Regulation), regulate franchising in Ontario. They specifically address such issues as the contents of disclosure, the timing of disclosure, exemptions from disclosure, remedies for the breach of disclosure obligations, and a number of other elements of franchise practice in the province.

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Under the Ontario Act a franchisor is required to provide a single disclosure document to a potential franchisee. The franchisor must do this not less than 14 days before the earlier of: (a) the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise; or (b) the payment of any consideration by or on behalf of the prospective franchisee relating to the franchise. The disclosure document must contain all material facts, financial statements, copies of all agreements relating to the franchise, prescribed statements, and other information as prescribed in the Ontario Act and the Ontario Regulation. Additional requirements as to the specific information that must be included in a disclosure document are provided in the Ontario Regulation. For a summary of the information that needs to be disclosed under the Ontario Act and the Ontario Regulation please refer to Appendix I. The Ontario Act also stipulates a number of exemptions from disclosure obligations. These exemptions include: the grant of an additional franchise that is substantially the same as the existing franchise, so long as there is no material change since the existing franchise; the grant of a franchise where the franchisee is investing more than $5 million over a period of one year; and the renewal or extension of a franchise agreement where there was no interruption in operation and was no material change since the original franchise agreement.

The Ontario Act stipulates strict liability for breach of disclosure obligations on the part of the franchisor. This can be seen in the remedies that the Ontario Act provides for the franchisee. A franchisee can rescind the franchise agreement without penalty or obligation as long as it does so within 60 days of receiving the disclosure document. It can do this in any case where the franchisor has failed to provide the disclosure document or a statement of material change within the prescribed time, or if the content of the document does not meet

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40 S. 5(1) of the Ontario Act.  
41 S. 5(4) of the Ontario Act.  
42 S. 5(7) of the Ontario Act.
the requirements prescribed by the Act. If the franchisor did not provide a disclosure document the franchisee has the right to rescind within two years of entering into the franchise agreement. Rescission imposes certain obligations on the franchisor. These include the obligation to refund all money received from the franchisee (other than those funds used for inventory, supplies or equipment), to purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement, and to compensate the franchisee for any losses that it incurred in acquiring, establishing, and operating the franchise. Additionally, in the case where the franchisee suffers a loss because of misrepresentation made in the disclosure document or statement of a material change, or because the franchisor did not comply with the disclosure requirements of the Ontario Act, the franchisee has the right to bring an action for damages against the franchisor. The franchisee also has a right to bring an action for damages against the franchisors’ agent, broker, associate, and every signatory of the disclosure document or statement of material change. Misrepresentation is defined in a manner that includes any untrue statement of material fact, as well as any omission to state a material fact that is required to be stated, or that is necessary to make a statement not misleading in light of the circumstances in which it was made. The liability provisions in Ontario franchising regulation are very detailed. This illustrates the emphasis placed on franchisee protection by the legislation. This is an approach that can be adapted to the Russian system.

The Ontario Act provides for a number of defenses to an action for misrepresentation. One of these defenses is a general defense that is available to all persons including the franchisor. Under the Ontario Act a person is not liable in an action for misrepresentation if the person can prove that the franchisee acquired the franchise with knowledge of the misrepresentation.

43 S. 6(1) of the Ontario Act.
44 S. 6(2) of the Ontario Act.
45 S. 6(6) of the Ontario Act.
46 S. 7(1) of the Ontario Act.
47 S. 1(1) of the Ontario Act.
or of the material change.\textsuperscript{48} Other available defenses to an action for misrepresentation relate to persons other than the franchisor. These defenses apply if the person proves, for example, that the disclosure document or statement of material change was given to the franchisee without the person’s knowledge or consent. The person is also required to have notified the franchisee about this fact upon becoming aware of it, or if that person withdrew its consent to the disclosure document and notified the franchisee before the acquisition of the franchise.\textsuperscript{49}

The nature of franchise regulation can significantly contribute to the development of the practice of franchising in a jurisdiction. To a certain degree, franchise practice in Ontario reached the highly developed state it is in currently as a result of the advanced nature of Ontario franchise legislation. Ontario franchise practice, its regulation, and the significant causal relationship that arguably exists between them, can serve as a good illustration of why current franchise regulation in Russia needs to be revised. Franchise regulation in Russia is broad and outdated. In this state it cannot sustain or facilitate positive development of the Russian franchise practice. Russian legislation defines franchise in very broad and basic terms and it does not stipulate disclosure obligations. Moreover, the franchise agreement does not function as the main regulating instrument of the franchise relationship. Without an appropriate legal base the franchise model will not progress past its current state. Legal transplantation, as a comprehensive instrument of modern legal evolution,\textsuperscript{50} can be used effectively by Russian theorists to update the country’s franchise regulation. North American legislation, in particular the legislation found in Ontario, can be used as a good model for transplantation. However, Ontario franchise legislation should first be carefully analyzed in order to avoid possible complications with transplantation.

\textsuperscript{48} S. 7(4) of the Ontario Act.

\textsuperscript{49} S. 7(5) of the Ontario Act.

Analysis of Complications with Ontario Franchise Regulation

Despite the sophisticated nature of Ontario franchise legislation some uncertainties remain. These uncertainties can lead to a number of complications in franchising practice. One issue concerns the substance of information to be disclosed. The Ontario Act requires the disclosure of any material fact, the definition of which is open-ended. The definition includes any information pertaining to the business, operations, capital, or control exercised by the franchisor or franchisor’s associate. The definition also includes any information about the franchise system that would reasonably be expected to have a significant effect on either the value, or price, of the franchise to be granted, or the decision to acquire the franchise.\(^5\) Difficulties may arise in the process of compiling a disclosure document due to the non-exhaustive list of information to be disclosed and the complexity of the definition of “material fact”. The disclosure of information is necessary for the franchisee to make an informed purchasing decision.\(^5\) One major challenge is to find the correct level of disclosure that makes the decision “informed”. If the appropriate level of information was not provided the franchisee may potentially have a right to rescind the franchise agreement. More uncertainty is added by the second part of the definition of the material fact. This part of the definition includes information that can have a significant effect on the decision to acquire the franchise. Different information will have a different effect on different franchisees. This fact forces franchisors to consider the materiality of information on a case-by-case basis which requires additional time and money.

Additional concerns are raised by the requirement to provide to a franchisee a statement of any material change as soon as is practicable after the change has occurred, and before the

\(^5\) S. 1(1) of the Ontario Act.
\(^5\) *Dig This Garden*, supra note 30 at para. 16.
earlier of: (a) the signing of an agreement relating to the franchise; or (b) the payment of any consideration relating to the franchise. Material change, in general terms, is a change in the franchisor’s business or in a franchise system that would reasonably be expected to have a significant adverse effect on the value of the franchise to be granted or on the decision to acquire the franchise. This includes a decision to implement a change to the franchise by the franchisor’s board of directors. Practically the main concern is that neither the Ontario Act nor the Ontario Regulation provides any guidance regarding the conditions that are required for an adverse change to be deemed “significant”. Depending on the interpretation of this term by parties, and especially by courts, the consequences for the franchisor can be quite severe.

One difficulty with Ontario franchise practice and, thus, in its transplantation to the Russian legal system, concerns financial statements. Financial statements must be provided to the franchisee by the franchisor, and they must comply with the Canadian Institute of Chartered Accountants review engagement standards. This requirement results in additional, unjustified, costs for foreign franchisors who wish to expand in Ontario, and who have already prepared their financial statements in compliance with different accounting principles. If the Ontario model is to be transplanted into Russian franchise legislation, Generally Accepted Accounting Principles (GAAP) should be the only standard to which any required financial statements should conform. The problem that Russian franchisees may be unaccustomed to GAAP can be addressed by employing the resources of the Russian Franchising Association. This association can provide the necessary training to those franchisees that wish to conduct business with a foreign franchisor.

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54 S. 1(1) of the Ontario Act.
56 Ss. 3(1)(b) and (c) of the Ontario Regulation.
57 Zaid, supra note 54 at 13.
An additional uncertainty in the Ontario franchise practice involves earnings claims and projections. The majority of franchisees’ requests concern information about earnings. If they do not receive this information from the franchisor they will seek it from other sources and third parties like franchise salespersons and in doing so they run the risk of receiving information that is not credible. Under the Ontario Act there is no obligation on the part of the franchisor to provide earnings claims or projections. However, in some cases a franchisee could argue that information about earnings claims is material and thus subject to disclosure requirements. At this point an additional deficiency becomes clear: neither a definition of, nor guidance in respect to, the meaning of “earnings projections” is given in the Ontario Act or the Ontario Regulation. Without guidance on this issue there is too much room for a debate as to the scope of earnings projections within the regulation. The question is whether the regulation applies only to projections, or to the use of all future oriented financial information (FOFI) which includes both projections and forecasts. Or further, whether it regulates earnings claims generally; this would mean that it includes both FOFI and financial information based on actual experience. One solution could be to refer to the Prince Edward Island Franchises Act Regulations (P.E.I. REG. EC. 232/06) (PEI Regulations), or the Amended and Restated UFOC Guidelines. These regulations provide greater guidance about earnings claims.

With respect to earnings projections, a statement specifying the “reasonable basis” and “underlying assumptions” for the projections should be provided. Once again, the Ontario Regulation and the Ontario Act do not provide guidance in respect to what constitutes a

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58 Kevin Adler, “From the International Franchise Expo” (May 2008) 14:8 LJN’s Franchise Business & Law Alert 1 at 4.
61 S. 6(1)3 of the Ontario Regulation.
“reasonable basis” for the provision of earnings projections. A possible solution can be taken from U.S. sources. Under U.S. franchise regulations “underlying assumptions” include significant factors upon which a franchisee’s future results may depend. Such factors include economic or market conditions that are basic to a franchisee’s operation. This encompasses matters affecting, among other things, a franchisee’s sales, the cost of goods or services sold, and the operating expenses. The reasonableness of financial estimates is determined by standards for projections that are issued by professional organizations such as the American Institute of Certified Public Accountants, e.g., the Prospective Financial Information: AICPA Audit and Accounting Guide (2006). Factors that define reasonableness include good faith, adequate documentation, and appropriate care by qualified personnel. While U.S. franchise regulation might not be recognized by the Ontario courts, it can still be employed by Russian theorists to create more effective regulation regarding earnings claims.

The provision of financial information, such as earnings projections, can have a number of positive effects on franchising. These effects include the attraction of additional franchisees and the facilitation of a franchisee’s positive performance. Despite these benefits many franchisors do not provide this information to franchisees. According to one study, approximately 20% of American franchisors provide potential franchisees with information regarding earnings claims. It is a rare practice for a number of reasons. Such reasons include the significant cost of keeping up-to-date information, the negative views of the franchise that are created if projections are not very strong, and the possibility of litigation if

62 Franchise Rule Compliance Guide at 91.
63 Ibid.
64 Ibid.
65 Ibid.
earnings are misrepresented.\textsuperscript{68} These considerations can often outweigh any positive effect this information might have. However, if adapted to the Russian legal context and implemented as a part of the Russian franchise disclosure process, earnings claims can make it easier for franchisees to understand the commitment they are about to make. However, in the process of implementation, one should note that the Russian legal system does not thoroughly regulate disclosure of financial forecasts. In particular, misrepresentations, remedies, and defenses relating to forecasts are not sufficiently regulated. This means that if the disclosure of financial forecasts is to be stipulated in Russian franchise law, it may take a significant amount of time for the practice to develop and for market actors to adapt.

The following are additional examples of why certain provisions of the Ontario Act and the Ontario Regulation require further elaboration. The Ontario Act provides exemptions from the disclosure obligation if the “total annual investment to acquire and operate the franchise” to be made by the franchisee is not more than $5,000,\textsuperscript{69} but nowhere does it define “total annual investment”. The wording of this section allows for the exercise of broad discretion in its interpretation. Considering the degree to which courts in Ontario protect franchisee’s interests such discretion can create substantial complications for the franchisor. This is because different interpretations can change the scope of the definition. Additionally, several provisions of the Ontario Regulation require franchisors to provide a “description” of certain facts in the disclosure document. This includes a description of bankruptcy proceedings initiated in respect to the franchisor,\textsuperscript{70} training or other assistance offered to franchisees,\textsuperscript{71} and of any restrictions or requirements imposed by the franchise.\textsuperscript{72} What is

\textsuperscript{68} Dillon & So, supra note 65 at 15.
\textsuperscript{69} S. 7(g)(i) of the Ontario Act and s. 9 of the Ontario Regulation.
\textsuperscript{70} S. 2.6 of the Ontario Regulation.
\textsuperscript{71} S. 6(1)5 of the Ontario Regulation.
\textsuperscript{72} S. 6(1)7 of the Ontario Regulation.
uncertain is the level of detail that needs to be provided. This creates a difficult situation for the franchisor when it comes to providing this information. On the one hand, the disclosure document should be “clear and concise”, but on the other hand, since there is no guidance given as to what constitutes a complete disclosure, a sufficient amount of information should be given so that the franchisee can make an informed decision.

Ideally the rights and obligations of the parties in any relationship should be balanced. However, more problematic issues are created by the judicial application of the Ontario Act because the rights of franchisees are given preference. In *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, 2008 ABCA 276, an Alberta case, the franchisee sought the remedy of rescission within the two-year period on the basis that the disclosure document was never provided. The disclosure document contained all the required information except for the signed certificate of disclosure. Because of that, the franchisor relied on the provision of the Alberta Act which states that a disclosure document is properly given if it is substantially complete. The court, however, rejected this argument and upheld the franchisee’s claim. Even though a signed certificate was not important for the franchisee’s purchasing decision, the court stated that despite the “substantially complete” allowance in the Alberta Act, the requirement of a signed certificate is mandatory and the franchisor must comply with it. In similar cases, *6792341 Canada Inc v. Dollar It Ltd* (2009), 95 O.R. (3rd) 291 (C.A.) and *Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc.*, 2008 CanLII 57450 (ON S.C.), the franchisor failed to disclose some information to the franchisee. In both of those cases the courts, once again, stressed that it is essential for franchisors to comply with the Ontario Act. If franchisors fail to comply then the non-compliant disclosure document will be deemed to be no disclosure at all. An analysis of these and a number of other similar decisions shows that there is still no uniform

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court practice for determining when a disclosure document will be deemed by courts to be non-compliant. For the purposes of S. 6(2) of the Ontario Act a non-compliant disclosure document is equivalent to the situation where no disclosure document has been provided at all.74

An analysis of the legislation and judicial practice regarding franchising in Ontario shows that franchisees’ interests dominate franchise practice in the province. Such practice can be explained by the consumer protection nature of the Ontario legislation. However, the stringent protection of the interests of one party in a relationship can have significant adverse effects on the business of franchising in general. Many practitioners are of the opinion that Canadian franchise legislation, and in particular the Ontario legislation, is “the most punitive franchise legislation in the world in terms of disclosure”.75 While it facilitates the growth of small business, it may hamper the development of established businesses. Without established franchisors in the market there will be fewer franchising opportunities for small businesses. The strictness of legislation significantly influences the decision of franchisors to enter a particular market. Franchisors will weigh the costs of compliance with strict legislation against potential profits. If the legislation is too strict existing franchisors might leave the jurisdiction and new franchisors will be reluctant to enter the market.76 Only legislation that maintains a balance of each party’s interests will facilitate the growth of franchise practices. Finding the right balance between the franchise parties’ interests is particularly important if Ontario franchise legislation is to be used as a legal transplantation model for Russian legislation. During the process of creating disclosure obligations in Russia, Russian theorists should also acknowledge the fact that in the end it is in the franchisor’s interests to provide full and accurate pre-franchise disclosure information to a

76 Ibid. at 63.
franchisee. Since the success of the franchisor depends on each franchisee in the system it must ensure the success of each franchisee. One way to do this is by providing franchisees with accurate information. Besides helping franchisees make an informed decision about whether to buy a franchise, pre-franchise disclosure of information also helps assure franchisees that no other factor will impede the performance of their outlets. Such factors can include the franchisor’s previous poor financial performance or previous convictions of the franchisor’s directors. Acknowledgement of this fact would allow Russian theorists to better determine the most effective scope of information that would need to be disclosed to a potential franchisee. This determination would result in more effective regulation of the disclosure process in Russia.

Despite the outlined issues, Ontario franchise legislation can still serve as a good model for legal transplantation into Russia. Currently Russian franchise legislation regulates the general concepts of franchising. However, it does not regulate disclosure obligations. Implementation of requirements to disclose certain information in Russian franchise legislation could significantly benefit the current franchise practice in Russia. Disclosure obligations can result in fewer violations of the parties’ interests, and allow franchisees to make a more informed decision when buying a franchise. The amended Russian franchise legislation would be more effective if it avoided the problems that are present in Ontario. The same applies to the legislation of any North American jurisdiction that is to be used as a transplantation model. To address this issue a functionalist approach to legal transplantation should be employed. Under this approach a legal norm, before it is transplanted, is analyzed with respect to the extent that it can perform the same function in the new system. The legal norm is then adjusted to fit the local context.77 Applying this approach many of the issues in

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the Ontario legislation can be resolved. In the end the most effective franchise provisions from different jurisdictions can be implemented into Russian legislation.

Analysis of Reasons for Complications with Ontario Franchise Regulation and Possible Solutions Available During the Process of Transplantation

The above analysis has shown that problems with the interpretation of legislation can arise because there is not enough explanation provided of the key terms in the legislation. This is especially true with respect to many elements of the disclosure process. While the disclosure requirements of the Ontario Act and the Ontario Regulation discussed above play a significant role in creating a complete and objective disclosure document, they should nonetheless be explored further. The first way to do this could be for the legislature to elaborate on certain aspects of the legislation. This can be a more cost-effective solution than establishing judicial precedents. The legislature has the authority to create regulation that would not leave room for any doubt in its application. However, the legislative initiative must be justified by thorough legal research. Thus, establishing legal precedent can be a more practical solution. This is because a precedent can be applied in one case and distinguished in another. Additionally, a legal precedent will show how a particular provision of law can be applied to the facts of a particular situation. This is sometimes more useful than a general provision of law. This solution would not, however, be appropriate for Russia. The problem is that there is no precedent doctrine and the role of the courts in interpreting the law is insignificant in Russia. The third possible way of elaborating on the meaning of the law is through legal research, and in particular legal commentaries. This approach would be well suited to the Russian practice. Despite the fact that legal theory does not have substantial legal authority, and can be rejected by both the parties and the courts, it can often be very beneficial for business relations. Scholarly research is useful for
resolving substantive theoretical issues. Research done by practitioners can significantly help with pressing and current issues in the industry. However, the analysis of the legal research on franchising in Ontario shows that some portion of it suggests that franchisors should disclose as much information as possible in order to avoid any potential liability.\(^7\) Under the current regulatory circumstances this is the best solution but, clearly, it is not optimal. Facilitating the creation of an efficient practice should be the foremost priority of legal research. In respect of Russia there are also a number of other factors that make legal research a more viable option. Russian legislation often has very broad provisions that are not elaborated on. Further, court decisions generally do not contain substantial theoretical reasoning. Therefore, legal research, especially commentaries on the law, should be the main source of guidance to parties engaged with the more complicated parts of franchise law.

As the above analysis shows, many complications with the Ontario franchise legislation and practice result from the breadth of legal requirements, the ambiguity of these requirements, or the lack of clarification with respect to those requirements. One could argue that such troublesome requirements should simply be omitted in the process of transplantation, especially considering the fact that Russian legislation does not conform to most North American legislative standards. It is certain that additional effort would be needed to adapt certain provisions of the Ontario legislation, or the legislation of other North American jurisdictions, to the Russian context. However, despite the cost of this effort Russian theorists should not entirely omit these sections. One of the reasons why these provisions should be kept is because, if properly stipulated, they can significantly contribute to the effectiveness of the disclosure process. They can also help the franchisee make a more

informed decision. If successful these concepts could later be transferred to other spheres of Russian legislation, such as corporate or contract law.

One of the main issues with Ontario franchise legislation is that it provides very stringent protection for the interests of the franchisees. Sometimes this works to the detriment of franchisors’ interests. A balance could be found by limiting the scope of the current definition of a franchise in the Ontario Act. After this is done, the amended definition could then be transplanted into Russian legislation. This would help to facilitate the creation of a proper disclosure process. Currently the definition of a franchise under Russian legislation is very general. In Russia a franchise includes the grant of a right to use intellectual property rights for a fee in an entrepreneurial activity either for a specified term or without such specification. The Ontario Act defines “franchise” in a much more elaborate manner. As such, it is better suited to facilitating an effective disclosure process. However, to create an even more effective disclosure process, this definition would benefit from a certain amount of revision.

As was earlier stated, the present definition of a franchise in the Ontario Act is so broad that it can cover a number of other non-franchise relationships. These relationships are often structured in a way that is similar to franchising. One example of such a relationship is product distribution. It is also noted that this definition protects the interests of small businesses. However, it unjustifiably burdens more sophisticated companies. These companies can sometimes fall under the category of a franchisor even without their knowledge. By creating the risk that companies may become accidental franchisors the definition undermines the efficiency of a number of market transactions. It also forces companies and their advisors to consider previously unknown risks.

79 S. 1027 of the Civil Code.
Limiting the scope of, or giving additional clarification to, the definition of a franchise in the Ontario Act will create a more balanced application of this definition. This new definition would then be suitable for transplantation into the Russian legal system. The definition of a franchise in the Ontario Act consists of three main elements: the franchisor’s trademark, the franchisor’s control and assistance in the franchise, and the payments made by the franchisee to the franchisor. Legislators can build a more harmonized franchise practice by limiting the scope of these elements, or by providing additional clarification for all three of them. The Russian business sector is dominated by large companies. Further, many Russian franchisees are relatively inexperienced and lack substantial financial resources. As such, one could argue that the wide scope of franchise provisions is justified, at least immediately following the introduction of the new regulation. However, a number of other factors should be considered before the introduction of such a broad franchise definition. These factors are wide-spread corruption, an ineffective judicial system, and weak rule of law. These problems can deter foreign investors from entering the Russian market. Considering these problems, the introduction of a broad franchise definition into Russian practice would be an additional deterrent for foreign franchisors.

One possible change that could be made to the definition of a franchise within the Ontario legislation is to more specifically outline the element of payment. This change would help adapt the legislation to Russian practice. The current definition in Ontario requires the franchisee under contract or otherwise to make “a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor’s associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations”. It is clear that this definition covers

80 S. 1(1) of the Ontario Act.
almost any payment, or commitment to make a payment, by the franchisee that has even a minimal connection to the franchise being offered. As a possible guide for creating an efficient transplantation model one could refer to the Alberta Franchises Act, R.S.A. 2000, c. F-23. (Alberta Act), which has a much narrower definition of a franchise. One could also refer to the Franchise Rule Compliance Guide. The Franchise Rule Compliance Guide is perhaps the most useful as it provides more detailed guidance regarding the criterion of payment, as well as guidance relating to the definition in general. As a condition of obtaining a franchise or starting operations the Franchise Rule Compliance Guide requires that payment of at least $500 be made during the first 6 months of operation.81 While “payment” is an inclusive term the Franchise Rule Compliance Guide provides a substantial explanation of its application. This approach can serve as a good model during the process of amending Russian franchise legislation and/or writing a legal commentary on it.

As far as the trademark element of franchise legislation is concerned, Canadian legislation and the Franchise Rule Compliance Guide are substantially the same. The exception is the Ontario Act, which provides the option for a relationship to be deemed a franchise even if no object of intellectual property is involved.82 Under Canadian franchise acts there is no requirement that the object of intellectual property be formally licensed to the franchisee. However, there must exist a substantial association between the goods or services provided and the franchisor’s intellectual property. Unfortunately, no guidance is given as to the meaning of “substantial association”. This makes it possible that offering goods or services with a trademark on the packaging can also satisfy this franchising requirement.83

81 Franchise Rule Compliance Guide at 1.
82 S. 1(1) of the Ontario Act.
The last element, control and/or assistance, can serve as another useful criterion to differentiate franchise from non-franchise relations. Currently, the Russian definition of a franchise does not differentiate between degrees of control and/or assistance. The definition only contains the general requirement that the franchisor should provide assistance with, and exercise control over, the goods and services. In order to make the requirement of control and/or assistance more effective in the Russian legal system additional clarifying definitions would also need to be adopted. The Franchise Rule Compliance Guide explicitly states that the significance of the requirement of control and/or assistance depends on the specifics of the relationship, and on the degree to which a franchisee relies on the franchisor’s control or assistance. It also provides numerous examples of significant and non-significant control and assistance. The logic and examples provided in the Franchise Rule Compliance Guide can be used as a guide for Russian legislators.

Creation of the New Franchise Regulation in Russia

The three revised elements of a franchise definition, combined with appropriate clarifications and drafted using the experience of other jurisdictions, would create a sophisticated basis for an effective disclosure process in Russia. These elements are extremely important in defining a franchise. This importance dictates the adoption of a separate bill on franchising. This is important because it would be impossible to set out in necessary detail all of the elements, as well as their explanations, in the Civil Code. A separate bill would allow for greater flexibility not only in respect of the definition of a franchise, but also in respect of other important parts of franchise regulation. The rights and obligations of the parties, or the termination and renewal of the franchise agreement, are important parts of franchise legislation that would also benefit from a separate franchise bill. Adoption of a separate bill

84 Franchise Rule Compliance Guide at 2.
would also lead to the creation of legal commentaries. This can play an important role in the establishment of a revised franchise practice. These two facts - adoption of a new bill on franchising and creation of commentaries on it - represent a good opportunity to create a highly sophisticated and effective franchising regulatory scheme in Russia.

In order to be transplanted into Russian practice a number of other elements of Ontario franchise regulation need to be addressed. As previously stated, several problems with the Ontario Act and the Ontario Regulation arise as a result of ambiguities contained in the legislation and/or the absence of a settled interpretation of certain terms. These terms include: “significant”, “material”, “reasonable”, “total annual investment”, and “substantially the same”. Problems can be avoided if in the process of transplantation the required interpretation or clarification is provided in the act and/or in commentaries. Additional complications are created as a result of the inclusive character of certain provisions of the Ontario Act. They include the provisions that define “material fact” and the “franchisor’s associate”. A careful analysis by Russian legal scholars of the breadth of such provisions would be required. Finding the right balance between flexibility and certainty is a necessity. When creating a model for transplantation, the Ontario Act should not be the only act used. In some instances the Ontario Act does not provide guidance with regard to particular elements of disclosure, such as earnings claims. On the other hand, the PEI Regulations have a much more elaborate regulation of earnings claims. In contrast to the Ontario Act, the Alberta Act allows for the possibility of signing a confidentiality agreement with the franchisee before disclosing sensitive information. If the goal is to create the most effective franchise regulation in Russia legislators should carefully review, analyze, and compare provisions of several other franchise acts as well.
The new franchise act in Russia would also regulate other significant elements of the disclosure process. These elements include the contents of the disclosure document, valid exemptions, and available remedies for failure to disclose. The Ontario Act can be used as a starting point for the creation of a model to be used in the Russian practice. The Ontario Act is appropriate because the substantial presence of business in the province has lead to the creation of more judicial decisions. These decisions are helpful references as they contain additional explanation on unclear issues. A better outcome, however, would be achieved by incorporating the models of other Canadian franchise acts, while using the Franchise Rule Compliance Guide for reference purposes. The comparison with other franchise acts would allow legal theorists to find the most appropriate and efficient regulation for the Russian context. Additionally, using the Ontario Act alone would not suffice because often it does not provide the most optimal regulation. Analyzing alternative regulative standards would be highly advisable.

During the process of adaptation Russian theorists and practitioners will be faced with the challenge of deciding whether or not to adopt certain provisions from different North American jurisdictions. This decision should be based on whether the regulation can be justified in Russian legal practice. This challenge arises because many elements of the North American legal system, and of those relating to franchising in particular, are not regulated in great detail in Russia. The provision respecting earnings claims, for example, is not thoroughly regulated in Russia. Many useful alternative dispute resolution mechanisms, like settlement conferences or summary trials are not used in Russian practice. The exception is arbitration and settlement. The underdeveloped nature of the Russian legal system can result in many of the procedures that are familiar to foreign investors to be ineffective with Russian counterparties. North American legislation is dependant on such concepts as fair dealing and a standard of reasonableness. These are concepts that the Russian legal system employs to a
very insignificant extent. Introducing these elements into the Russian legal system would create many uncertainties for Russian market actors. Adjusting to these uncertainties would require a significant amount of time. This could lead to some reluctance on the part of the legislature to adopt this new regulation.

In the end, despite the significant efforts and costs, imposing disclosure requirements on franchisors will result in fewer violations of the franchisees’ rights. This fact will help to attract more franchisees. Additionally, the Russian franchise market will then be able to attract more North American franchisors if its disclosure laws are based on North American legislation. Moreover, if the transplantation is overseen by a coalition of both Russian and Canadian scholars, and practitioners, then there are likely to be benefits on both sides. The Canadian side may benefit from this process if it yields theoretically justified solutions to problems with Canadian franchise legislation. For Russia the benefits would not be limited to the franchise practice. Many provisions could also be transferred into other spheres of law. To facilitate the use of the new franchise legislation in Russia, the Russian Franchise Association can play an important role. This Association could provide additional help by educating franchisees, providing explanation of the legislative requirements, and/or facilitating the creation of business contacts. Additionally, the authority to supervise the disclosure process can be vested in the Russian governmental body that currently registers franchise agreements. Since Russian companies will be unfamiliar with the new franchise requirements this governmental body can be given the necessary authority to protect parties’ interests in franchising. This authority would involve the ability to review complaints, impose penalties on an offending party, or initiate legal proceedings. Such a role of this governmental body would be very beneficial for franchisees because usually they are small entrepreneurs who lack both broad business experience and the funds required to effectively protect their interests. The current undeveloped nature of franchise business in Russia
illustrates the need for change. If the above suggested changes are correctly implemented then Russian franchise practice will have much greater development prospects. Of particular importance is the implementation of disclosure requirements.

Chapter Three: Additional Specifics of Franchise Regulation in Ontario

Disclosure requirements constitute only one part of a productive franchise relationship. Other elements of the relationship include the objects of intellectual property, payment of fees by a franchisee, and termination/renewal of the franchise agreement. However, many of these elements will not be examined in this thesis. The reason is that for the most part their governance by Russian franchise legislation is substantially the same as in Ontario. Elements that will be covered in this chapter are those that are not thoroughly regulated in Russia. These elements should be closely analyzed by Russian theorists so that they can be adapted to and constructively used in Russian practice.

Despite the fact that legislative regulation of some elements of franchising in the two countries is very similar, it could be very useful for Russian legislators to analyze North American judicial practice concerning those elements. Common law court decisions are very detailed and the *ratio decidendi* of such decisions can be used in providing additional guidance to Russian legislators. Currently, Russian legislation, and franchise legislation in particular, is very general. The legal reasoning in North American court decisions could be used to clarify many of these general rules. For example, in respect of non-competition policies the Civil Code states, but does not elaborate on, several instances where each party’s rights can be restricted. Russian judicial practice regarding those restrictions does not provide any substantial guidance either. To fill this gap one can refer to Canadian court decisions. For example, a number of Canadian courts have stated that a non-competition
covenant in the agreement (a provision that restricts the ways that franchisor and the franchisee can compete) should be reasonable in its scope.\textsuperscript{85} Reasonableness will be determined on the basis of factors such as the geographic coverage of the system,\textsuperscript{86} the period of time involved,\textsuperscript{87} whether negotiations were undertaken by parties of equal bargaining power,\textsuperscript{88} and whether legal advice was given to both parties.\textsuperscript{89} These factors, which are mentioned in court decisions explaining restrictive covenants, can all be used by Russian legislators. They can be used to set clear standards of behavior for the franchising parties to follow, and for the courts to enforce. A similar approach can also be applied in relation to the elements that will be discussed later in this chapter.

**Duty of Fair Dealing and Good Faith**

One of the essential elements of Ontario franchise regulation, an element that Russian theorists should pay close attention to during the process of transplantation, is the duty of fair dealing. It is impossible to regulate every single situation that can arise during a franchise relationship. The imposition of the duty of fair dealing by the Ontario Act may significantly assist the parties in protecting their interests. Under the Ontario Act the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.\textsuperscript{90} No additional explanation or interpretation is given by the Ontario Act or the Ontario Regulation. Thus, in case of a dispute parties should refer to previous court decisions for additional guidance. A number of such decisions will be reviewed below. However, a detailed analysis of the duty of good faith and fair dealing is beyond the scope of

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\textsuperscript{86} Ibid. at para. 26.

\textsuperscript{87} Ibid.

\textsuperscript{88} Yellowhead Petroleum Products Ltd. v. United Farmers of Alberta Co-operative Ltd. 2004 ABQB 665 at para. 44.

\textsuperscript{89} Ibid.

\textsuperscript{90} S. 3(3) of the Ontario Act.
this work. As such, only general concepts of the duty, and the possibility of their application in Russia, will be examined.

In general terms, the duty of good faith is “an expectation of each party to a contract that the other will honestly and fairly perform his duties under the contract in a manner that is acceptable in the trade community”. 91 Many scholars and judges agree that the duty of good faith is not precise and that its content is determined according to the circumstances of each case. 92 However, there have been a number of attempts to clarify the meaning of the duty of good faith. In Gateway Realty Ltd. v. Arton Holdings Ltd. and LaHave (No. 3), (1991) the court stated that good faith conduct “is the guide to the manner in which the parties should pursue their mutual contractual objectives”, and that the standard of good faith prohibits “conduct that is contrary to community standards of honesty, reasonableness, or fairness”. 93 According to the leading American case on this issue, Kirk LaShelle Co. v. Paul Armstrong Co. (1933), good faith is defined as “the implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract, which means that in every contract, there exists an implied covenant of good faith and fair dealing”. 94 The duty of good faith is often determined by the party’s bad faith conduct. Bad faith conduct can include conduct that is “untruthful, misleading or unduly insensitive”. 95 According to Mesa Operating Ltd. v. Amoco Canada (1994) “the common law duty to perform in good faith is breached when a party acts in bad faith, that is, when a party acts in a manner that substantially nullifies the contractual

objectives or causes significant harm to the other, contrary to the original purposes or expectations of the parties”.

In the end, it is the broad scope and flexibility of the duty to act in good faith that serves parties’ interests. Such breadth allows the parties to apply the duty to an endless number of situations. It would be impossible to regulate all of these situations by legislation or contract. The franchisor’s territorial encroachment on the franchisee’s business is a good example. In cases where the franchisor’s policy regarding territory or exclusivity was not disclosed to a franchisee, the actions of each party will be subject to the duty of good faith and fair dealing. In a number of cases courts have ruled that even if the franchise agreement did not prohibit the franchisor from competing with its franchisees, the franchisor’s decision to establish competition with franchisees will be governed by the standard of good faith. This gives franchisees the ability to challenge the decisions of the franchisor if they prejudice franchisees’ interests.

Analysis of the duty of good faith echoes debates about rules versus standards. Rules are defined as norms that attach definite legal consequence to a definite set of facts. Standards are defined as norms that can be applied after analyzing the facts of a particular situation. The main arguments in favor of rules are that they provide certainty and restrain official arbitrariness. Since rules are definite, and their official application is relatively straightforward, actors can easily adjust their behavior in advance. However, due to the definite nature of rules, they can often become disconnected from their objectives. This

98 Roscoe Pound, “Hierarchy of Sources and Forms in Different Systems of Law” (1933) 7 Tulane L. Rev. 475 at 482.
happens because different circumstances may require a different application of the rule while there is no flexibility in its application.\textsuperscript{101} This is not a problem with standards because they allow for more flexibility in responding to a particular situation.\textsuperscript{102} At the same time, standards are not without drawbacks. Since standards allow for broad flexibility, different interpretations of the standard may be possible. This can lead to the standard being applied inconsistently.

There are a number of different factors that can influence the formulation of norms \textit{ex ante} or \textit{ex post}. There are different types of costs that affect this process: the higher cost of creating rules due to the need for advance determination of a norm’s content\textsuperscript{103} is contrasted with the higher cost of becoming informed of the law’s content and enforcing it under a standard.\textsuperscript{104} Other factors include the over- and under-inclusive nature of a rule;\textsuperscript{105} the inability to formulate some legal norms as rules;\textsuperscript{106} and, most importantly, the frequency with which the law will govern conduct (frequent application of rules makes them more cost-effective than standards).\textsuperscript{107} These factors should be carefully considered by a government when creating new legislation. It is impossible to say that rules, or standards, are always superior to the other since “some activities are better governed by rules, others by standards”\textsuperscript{108}.

When considering the duty of good faith, it should be noted that its breadth can reduce its practicality. The possibility that such flexibility allows for abuse can diminish the efficiency of franchise regulation. The uncertainty created by the lack of clear definition of the duty

\textsuperscript{101} Ibid. at 62.
\textsuperscript{102} Ibid. at 63.
\textsuperscript{104} Ibid. at 572 and 570.
\textsuperscript{105} Ibid. at 591.
\textsuperscript{106} Ibid. at 599.
\textsuperscript{107} Ibid. at 621.
can also raise costs. Often additional time is required for the parties, and ultimately the courts, to interpret the meaning of the duty within a particular context. In case of a dispute it is only after a court has made its decision that the application of the duty of good faith to the particular situation becomes clear. The breadth of the duty requires the judicial system to take a proactive role since in the end it is the interpretation of the courts that influences the effectiveness of legal norms. Unfortunately, Russian courts cannot be relied upon to make legislation more effective. This is because, among other factors, there are many inconsistencies in Russian judicial practice. There is also the possibility that one party will be able to improperly influence a particular decision.

Even though the standards of fair dealing and good faith are stipulated in a number of places in Russian legislation their practical application is currently problematic. In general, Russian civil legislation does not contain many subjective standards, and courts rarely refer to them to solve disputes. There are several examples in the Russian Civil Code where the standards of good faith and fair dealing are applied. These examples include: using good faith and fair dealing to regulate a particular issue when that issue is not addressed by the legislation and where no analogy of law exists to be applied;\textsuperscript{109} the exercise of authority in good faith and in a reasonable manner by a person that is acting on behalf of a legal entity,\textsuperscript{110} and the protection of \textit{bona fide} buyers of goods.\textsuperscript{111} There are also a number of other examples that can be found in the Civil Code. Under Russian civil legislation there is a general presumption of the duty of good faith and fairness in contractual relationships. However, this presumption has more theoretical than practical value. Some insight into the duty of fair dealing is given by the Code of Corporate Conduct – a compilation of non-enforceable

\textsuperscript{109} S. 6.2 of the Civil Code.  
\textsuperscript{110} S. 53.3 of the Civil Code.  
\textsuperscript{111} S. 302 of the Civil Code.
norms and standards for participants in capital markets. One of the very few norms in this code interpreting the standard of fair dealing states that a director of a company acts in good faith if he/she has no interest in a particular decision, has reviewed all available information about the decision, and is acting in the best interests of the company. Russian judicial practice is also very limited in regards to the duty of good faith and fair dealing. Since the application of fair dealing and good faith is not common in Russian legislation, there is also little guidance to be found in either legislation, or legal theory, as to how a party can prove that the duty of good faith and fair dealing has been breached.

Theoretically, the imposition of the duty of good faith in Russia can lead to positive results in both the area of franchising law as well as in other spheres of law. Russian legislators can use North American court decisions that interpret the duty of good faith as sources of guidance for Russian parties and courts. In Russia these concepts would be more effectively applied if they were explicitly defined, rather than stipulated as open-ended standards. One of the reasons is that Russian legal system does not employ equitable principles which are needed for the effective application of such standards. Further, parties and courts may face a number of complications interpreting and applying standards that they are not familiar with. Since many actors are not accustomed to open-ended standards it is essential that legal drafting be very clear. The duty of good faith is an essentially unknown standard to Russian actors and requires adaptation to Russian practice. This will help to facilitate its development. Unfortunately, efficient legal drafting is not one of the Russian legislature’s strengths. It would take a significant amount of time and effort for market actors and courts to accept, familiarize themselves with, and properly apply the new standard. If applied

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113 S. 6.1.1 of the Code of Corporate Conduct.
incorrectly, the flexibility of the duty could be detrimental to the parties’ legitimate interests, e.g. the imposition of unjustified requirements, or an increase in unwarranted claims and legal actions.

In choosing between a rule and a standard to regulate franchising relations in Russia, a number of general considerations should be taken into account. Russia does not have a long history of using standards as regulatory norms. Many market actors are not accustomed to open-ended standards, and thus do not use them to govern their relations. Courts do not rely on these standards when deciding cases. Many parties in their contracts simply copy, and do not elaborate on, provisions of legislation. These legislative provisions are mostly stipulated as rules rather than standards. These examples illustrate the fact that there is no urgent need for flexible norms in Russian legislation. Rules, on the other hand, do not allow for wide discretion and would be much more appropriate for use in the Russian practice. Additionally, one must consider the amount of corruption present in many Russian governmental agencies. Having this in mind, open-ended norms could result in the abuse of rights. As such, the argument that open-ended norms will help fill the many gaps currently present in Russian legislation is not persuasive. The current state of the legal and judicial systems in Russia cannot provide conditions that are appropriate for the introduction and development of such flexible legal norms. Unless the duty of good faith is stipulated in a straightforward way and an appropriate environment for the application of this duty is created, for the time being, the implementation of the duty of good faith in Russia is not justified. The benefits of this duty do not outweigh the negative effects that could occur after the duty is implemented.
Franchisee Associations

Russian franchise legislation provides very few other instruments for the protection of parties’ interests. Specifically, it is silent in respect to franchisee associations. The right of franchisees to associate with each other can give them significant leverage over franchisors. The effect of association is recognized and protected by the Ontario Act. Under the Ontario Act a franchisor shall not interfere with, prohibit or restrict, or penalize a franchisee from forming or joining such associations.\footnote{Ss. 4(2) and 4(3) of the Ontario Act.} Franchisees have a right to bring an action for damages against the franchisor if the latter contravenes the requirements of the Ontario Act in respect of franchisee associations.\footnote{S. 4(5) of the Ontario Act.} Despite these provisions, the Ontario Act does not compel a franchisor to deal with franchisee associations. It does not state how the relations between a franchisor and franchisee associations should be structured. The Ontario Act is similarly silent on what authority and/or instruments associations can employ when dealing with franchisors. However, if the franchisor does not recognize the authority of a franchisee association, the latter may be able to rely on the fair dealing provision in the Ontario Act. If they are successful they can claim damages for breach of the duty of fair dealing.

There are several reasons why franchisee associations may be beneficial for franchisees. The main goal of franchisee associations is to bargain over the terms and conditions of the franchise agreement.\footnote{Erik B. Wulff, “Actions by Franchisee Associations: Antitrust and Other Legal Complications for Franchisors and Franchisees” (1993) 13:2 Franchise Law Journal 37 at 63.} By coming together and representing the interests of many franchisees, the association acquires more leverage over franchisors than a single franchisee could on its own. Franchisees are usually small entrepreneurs who do not have substantial funds to protect and enforce their rights against the franchisor’s abusive actions. Franchisee
associations represent an effective solution to this problem. Aggregation of interests also allows the association to better communicate and negotiate with franchisors on behalf of franchisees.\footnote{David N. Kornhauser, “Franchisee Associations” (Paper presented on the conference Franchising Soup to Nuts, OBA, Institute of Continuing Legal Education, January 29, 2004) at 7 [unpublished].} The franchisor is also better able to understand and deal with the concerns of many franchisees if they are synthesized and conveyed together. Additionally, franchisees would not feel intimidated in expressing their concerns about the franchise through the association rather than on their own. A franchisee association can also help with cost sharing.\footnote{\textit{Ibid.} at 8.} The following are examples of situations that allow for cost sharing: initiation of negotiation procedures, the purchase of more effective advertisements, and the buying of supplies.\footnote{\textit{Ibid.} at 8.} It is also possible that the franchisee association will be able to engage in political lobbying on behalf of the franchisees.\footnote{\textit{Ibid.} at 10.} Such associations can also provide education and other help for franchisees that are in need. This educational role would be especially relevant for Russian practice. This is because there are very few other effective ways of educating those Russian franchisees that are unfamiliar with contemporary franchise regulation.

The existence of franchisee associations may also benefit franchisors. Even though the majority of the time a franchise is granted on the “take it or leave it” principle, franchisors cannot completely disregard franchisees’ interests. This is because the whole franchise system depends on those franchisees. With the help of an association franchisors are better able to understand the major concerns of a significant number of franchisees. This can foster a more efficient relationship. If concerns are conveyed by an association, rather than an individual, it often means that the problems are experienced by more than just a few franchisees. If a franchisor addresses these concerns they may see an increase in the franchisees’ performance, since the franchisees will feel that the relationship is not as one-
sided. Franchisors also benefit from franchisee associations because they make communication easier. This leads to problems being resolved in a more effective manner.

Currently, Russian franchise regulation does not regulate the status of franchisee associations. At the same time, it does not prohibit franchisees from establishing associations. However, without legislation designed specifically to regulate these associations they would be unable to exercise any real influence on the franchisor. Thus, they would be unable to effectively protect franchisees’ interests. Additionally, Russian business practice is often dominated by large businesses. Due to their connections and influence these businesses do not always consider the best interests of their counterparties. The consequences of franchisees associating and acting against franchisors could be unpredictable. Explicit regulation of franchisee associations would significantly contribute to the authority of the association.

Without additional regulation that specifically addresses franchisee associations there is a substantial possibility that franchisors will simply ignore franchisee associations. The imposition of the duty of fair dealing is one of the very few ways in which a franchisee association can exercise significant influence on a franchisor. The other viable solution would be to explicitly state the rights of a franchisee association, and obligations of a franchisor in respect of the association, in legislation. This option would create much clearer and more straightforward guidelines that would apply to the relationship between franchisors and franchisee associations. Even without the duty of fair dealing or the explicit regulation of franchisee associations’ relationship with a franchisor, a franchisee association may still be able to influence franchisors by careful coordination of franchisees’ activities. For example, an association could initiate the non-payment of royalties or advertisement fees by all, or a majority of, franchisees. In this case it might be less costly for the franchisor to
settle, rather than pursuing the franchisees for breach of contract. However, this may not always be the case, and the possible ramifications for franchisees can be severe. Indeed, legal action could be taken against the franchisees for violating the competition regulation.\(^{122}\)

Franchisee associations would be able to play a significant role in Russian franchise practice. This is especially true because many franchisees lack substantial experience and have very few other instruments available to protect their interests. For an association to be able to successfully conduct its activities, and protect the interests of its franchisees, it would require an official legal status. If franchisee associations are not provided for in specific regulation franchisees maybe reluctant to associate. This is because franchisees that associate may face prejudice from franchisors. For the time being, explicit legislative regulation of the rights and obligations between associations and franchisors is the best option. In contrast to a duty of fair dealing, legislative regulation of franchisee associations would correspond to the current practice of detailed legal regulation in Russia, would be much more familiar to market actors, and would not take as much time for them to adapt to it. Explicit regulation regarding franchisee associations would also be more definite and straightforward than the concept of the duty of fair dealing. As such, this regulation would be more acceptable to Russian actors.

**Alternative Dispute Resolution**

An additional element that is often used in franchising relationships in Canada is alternative dispute resolution (ADR). ADR is not an element of franchising *per se*, but part of the larger legal framework of North America. ADR can be very beneficial to those parties engaged in

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\(^{122}\) Wulff, *supra* note 116 at 66.
franchising relationships. ADR is especially important for franchising because franchising is usually a long-term relationship. The successful development of franchising is heavily dependent on trust between the parties. Court litigation, besides involving significant time and costs, is also likely to undermine the relationship by destroying trust between the parties. In the end, a party might be forced to search for another business partner, which means additional time, costs, and lost profits.

If Russian theorists were to use the same legislative model as Canada to create new franchising regulation in the country, they might also use the Canadian ADR model to implement new dispute resolution mechanisms. Other than arbitration and settlement, Russian legislation does not provide any procedures to resolve disputes before they reach litigation. Russian legal theory does contain analysis of many common ADR mechanisms. However, in actual practice such mechanisms are rarely used. It seems to be the case that unless ADR procedures are specified in legislation they will neither be acknowledged by, nor used in, Russian contractual practices. Russia can follow the example of countries like Argentina, where mediation is a mandatory pre-condition to litigation. Amending franchising legislation presents an opportunity to introduce various mechanisms that will aid dispute resolution in Russia. To begin with, ADR procedures should be specified in respect of franchising. This will serve as a testing ground. Later, similar procedures can be implemented in other types of contractual relations. Franchising can be a good testing ground for ADR in Russia because it could show how effectively that ADR mechanisms can be applied to a trust-based relationship.

ADR is a cheaper and faster way of solving disputes between parties. Even though courts have a much more substantial and binding authority, ADR mechanisms can still be very productive. Further, ADR mechanisms are good at keeping the relationship between the parties alive. In developed countries commonly used ADR procedures include: negotiation, neutral expert fact-finding/evaluation, mediation, arbitration, settlement conferencing, and mini/summary trials. Implementing these mechanisms into Russian practice could significantly harmonize contractual relationships. Contracting parties in Russia are often forced to refer their disputes to the courts because they are the only place that can provide a solution. In many cases disputes could be resolved and litigation avoided if parties were more objective in evaluating facts. This is especially relevant in a franchising relationship, where one party is significantly weaker than the other. Due to this power imbalance even if the offended party has evidence of improper conduct the other party is likely to view it with skepticism. In this case a neutral expert fact-finding/evaluation, or a settlement conference, could be successfully employed. A neutral expert or mediator, especially if the disputing parties agree on the selection and authority of that person, will be able to evaluate facts more effectively and lead parties to a mutual settlement. Even negotiations can be of considerable help in solving tensions between parties. Additionally, ADR mechanisms will be more practical in Russia because they will help parties to avoid Russian courts, where corruption often hampers the protection of legitimate interests.

In summary, there are several elements of Ontario franchise regulation that have been outlined as salient aspects of the franchise practice in Ontario. If Ontario regulation were to be used as a model for transplantation, Russian theorists should pay particular attention to those elements. Such elements, if properly implemented and applied, could significantly aid

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126 Ibid. at 3.
127 Ibid.
the development of franchising in Russia. These elements could also help parties to better protect their interests. However, there are other important structural elements of franchising in the province. The application of these structural elements would also be beneficial to the Russian environment if they were properly adapted to it. These structural elements include certain aspects of non-competition, and renewal or amendment of the franchise agreement. Legislative regulation of those elements in Ontario is substantially the same as in Russia. However, it is Ontario court practice that can provide Russian theorists with valuable insight into their application. The analysis of judicial practice in respect of such elements is beyond the scope of this work. However, if it is undertaken during the process of transplantation, it can help to create a much more effective franchise environment in Russia.

Chapter Four: Considerations to be taken into Account by Foreign Investors in Conducting Business in Russia

A significant amount of analysis in the previous chapters was devoted to franchising relations in Russia. However, the success of foreign investment in a franchise does not only depend on the state of franchising regulation. There are also other influential factors that foreign investors need to consider when entering the Russian market. They include the role of the government and the functioning of the legal and judicial systems. Since Russia is still a developing country there are a number of problems intrinsic to conducting business in the country. These problems include widespread corruption and poor law enforcement. This can significantly undermine the effectiveness of an investment if it is not closely monitored. This chapter goes beyond general considerations to highlight the particularities involved in doing business in Russia. The factors that are highlighted are those that investors should be most aware of. This overview may also be relevant because it describes the environment in
which new franchising legislation will have to function, which may affect the effectiveness of the new franchising bill.

**The Russian Legal System**

One of the main complications that investors face in Russia is the undeveloped legal system. For instance, it is often the case that Russian legislation does not contemplate many contemporary legal instruments. Many useful ADR mechanisms are rarely used by businesses, the assignment of bank accounts as a type of security is practically unknown to Russian parties, and Russian contract law poorly regulates concepts like indemnities, waivers of rights, and warranties. This is partly due to the fact that a substantial portion of Russian legislation was adopted in the late 1990s, and many statutes since then have not been substantially amended. Even though Russian law provides for freedom of contract, it also stipulates many mandatory provisions that cannot be contracted around by the parties. The Russian legal system is not flexible enough to support the use of foreign instruments like the use of escrow arrangements or assignment of bank accounts in transactions taking place in the country. The legal system often cannot provide an appropriate environment for many foreign instruments to function correctly. Further, foreign concepts may not be recognized by Russian courts. Powerful lobbies often influence the legislature to pass or amend laws in their favor. There have been very few attempts to comprehensively amend legislation in a manner that would carefully revise existing norms in a way that could support future development. When implementing legal amendments the legislature often focuses only on the statute that is being amended. Legislators often fail to consider the effect that their amendments have on other statutes, and vice versa. This creates a situation where after a new instrument is introduced its application is hindered by the absence of a contemporary legal framework, the existence of which is needed for the effective application
of the new instrument. The overall effect is that many business transactions in the country lack efficacy.

Often the problem of efficacy lies not with the law itself but with its application. Many spheres of Russian legislation are very well drafted. Labor, procedural, and intellectual property law are all governed by well drafted legislation. However, poor application significantly diminishes the overall effectiveness of legal regulation. Parties often do not get beyond provisions stipulated in legislation, nor do they try to adapt legal standards to the specifics of their relationship. Instead it is common practice to simply copy provisions of law into the contract governing their relationship. Modern legal research does not aid the development of the legal system as it appears to be ignored by contracting parties and legislators. The application of the law in Russia is also hindered by a number of other factors. These will be reviewed later in this chapter.

Despite such a negative outlook, foreign investors should not exclude Russia. Today many foreign investors are interested in the Russian market. In 2009 the inflow of foreign investment into Russia exceeded $40 billion. Among the reasons for entering the Russian market are the growing economy, the growing number of consumers, the growing wealth of those consumers, and the growing demand for quality foreign goods. These and a number of other factors create a favorable economic climate for international franchising businesses. The benefits that a franchise business could derive from the Russian economy considerably outweigh any barriers that may confront an investor.

In Russia it is possible for an investor to establish and fully own a company; establish a branch of an already existing company; or enter into an agreement with a Russian company/companies and/or individuals to create a joint-stock or a limited liability company. Some companies operating in industries like oil, gas, and telecommunication are deemed “strategic”, which means foreign investors face more complicated procedures for acquiring an interest in such companies.\footnote{See the Federal Law No. 57-FZ "On the Framework for Foreign Investment in Economic Organizations with a Strategic Importance for National Defense and Governmental Security".}

In respect of franchising, viable options include the grant of a master franchise or the creation of a multi-unit franchise. Foreign investors wishing to establish a business face relatively few difficulties in the early stages. Initial state registration, the initial grant of licenses and permissions, and other administrative procedures connected to the establishment of businesses do not usually lead to serious complications. Legislation regulating the operation of businesses in Russia is clear and does not create many obstacles for foreign businessmen. Regulation respecting such spheres as health, sanitary, and fire safety is straightforward as well. Generally, Russian legal rules would not force franchisors to change their business systems in order to operate in the Russian market.

When parties begin entering into various agreements one effective solution to problems posed by the undeveloped Russian legal system is to contract out of the Russian jurisdiction. This includes both the governing law of the agreement and the dispute resolution forum. In general, choosing extraterritorial governance brings the following benefits: improvement in the contracting environment, a better functioning judicial system, and better court specialization.\footnote{Jens Dammann & Henry Hansmann, “Globalizing Commercial Litigation” (2008) 94:1 Cornell L. Rev. 1 at pp. 10 - 14.} This option may be very beneficial since the Civil Code often fails to provide parties with a general legal framework that they can use to structure their relationship. The Civil Code also lacks many default rules that would help parties to lower transaction costs. Contracting out of the Russian jurisdiction can help parties avoid the
common and problematic situation where an agreement governed by Russian law does not have significant meaning in regulating the relationship. Often an agreement between Russian parties is simple, merely restates provisions of the Code, and lacks terms other than those prescribed by the law. This may be a feature intrinsic to civil law, but the fact remains that it detracts from the effectiveness of business transactions. Choosing foreign law to govern the agreements between parties allows them to enjoy the full benefits of freedom of contract as well as a wide range of other legal instruments and concepts not available in Russia. Referring a dispute to a foreign court will also help parties avoid the corruption that is pervasive in Russian courts. For the time being, subjecting the contract and dispute resolution to the law of another jurisdiction is one of the very few options available to the parties to a contract who wish to avoid certain deficiencies in the Russian legislation while building an effective relationship.

**Enforcement of Foreign Judgments**

The inability of Russian civil legislation to provide adequate governance for international business transactions and poor application of the law, are the main reasons why many international transactions are structured in accordance with the law of a common law jurisdiction. However, this measure does not always help to avoid inefficient Russian legislation. In some instances, such as those concerning immovable property, contracting out of the Russian jurisdiction is prohibited. Contracting out of the jurisdiction can also lead to problems when parties attempt to have the judgment of a foreign court enforced in Russia. According to Russian procedural law, decisions of foreign courts shall be enforced by Russian courts on the territory of Russia, provided that there is a treaty of reciprocal legal

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assistance with the relevant country. However, no such treaties exist with developed European and North American countries. Experience shows that foreign court decisions are rarely enforced, and sometimes only if politically motivated. Such was the case when a decision of a court in the United Kingdom was enforced in Russia against Yukos. A recent decision of the Superior Commercial Court of the Russian Federation, acknowledging and enforcing the decision of a Dutch court, does not guarantee change. This is because the doctrine of precedent does not apply in Russia. Since Russian law does not recognize many instruments that are widely used in developed countries, the main problem faced by a Russian judge is trying to understand the law on which the decision of a foreign court was based. The inefficiencies present in the Russian legal system can affect the decision of investors to enter the Russian market.

**Corruption and the Informal Sector**

Investors operating in Russia may face several problems after their business has been established. Wide-spread corruption and the existence of informal relations in the country are some of the main sources of complication. These two practices hamper proper application and enforcement of legal rules regardless of the quality of the rules. In Russia, corruption in the courts, rigged auctions, and corporate raids with the help of, or sometimes by, the government significantly vitiate the effect of civil regulation. In the end, foreign investors may suffer. When it is hard to seek justice, when payments are extorted by

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136 Rentpool B.V. v. OOO Podyemnye Tekhnologii (No. VAS-13688/09).
organized crime groups as well as public officials, and when there is no guarantee that business investments will be safe, people may not engage in business activities at all. If they are not completely deterred they may simply invest smaller amounts of money and effort.

According to the Global Corruption Report in 2009 Russia was ranked 147th, together with Bangladesh and Syria.\(^\text{137}\) Corrupt practices in Russia have come to the point where bribes are considered an ordinary part of life. Bribes have to be paid not only for favorable treatment but sometimes for activities that public officials are required to do.\(^\text{138}\) Various steps are taken by governmental agencies to induce the payment of bribes. The only government body that deals with company registration in Moscow, for example, requires that the CEO of the company appear in person to hand in an application for registration of amendments to the constitutional documents of the company. Sometimes the success of the entire business depends on the payment of bribes. Often this requires the help of intermediaries that “fix things”. Only afterwards can a company begin receiving profit.\(^\text{139}\)

The most adverse implication for businesses is that monetary payments are often extorted.\(^\text{140}\) Payments can be demanded not only for the performance of ordinary official actions but, sometimes, to ensure the safety of the business. The latter case is the most troubling for foreign investors. This is because in the case of noncompliance they run the risk of losing their business; and in the case of compliance they, or their company, run the risk of being prosecuted under acts such as the U.S. Foreign Corrupt Practices Act for bribing a foreign official. One of the campaign goals of the new president of Russia was to end corruption in


the country. However, investors share a general belief that the fight against corruption in 
Russia is illusory. This belief can serve as an additional deterrent to foreign investment.\textsuperscript{141}

Investors should also be aware that in the most extreme and rare cases extensive political 
involvement can lead to corporate raids. Often corporate raids are performed by the 
government, turning corporate takeovers into a form of expropriation. In some cases this is 
done by the Russian Procuracy, one of the main law enforcement agencies in Russia.\textsuperscript{142} 
Examples of companies forced to sell some of their assets to government-controlled 
companies include BP-Amoco, Royal Dutch Shell Plc, and Yukos.\textsuperscript{143} Some cases show that 
not only assets, but also the personal health of individuals, can become a target of the 
Russian government. This was illustrated by the sudden death of Mr. Magnitsky, who 
defended Hermitage Capital, an investment fund, against governmental expropriation.\textsuperscript{144} 
The cases against Yukos, and in particular those against Mr. Khodorkovsky, the company’s 
major shareholder, coupled with the death of Mr. Magnitsky, deter potential investors from 
doing business in Russia. This is because it is believed that these actions are politically 
motivated. In the case of Yukos it is believed that the whole process was started because 
Mr. Khodorkovsky planned to run for the presidency in 2008,\textsuperscript{145} supported opposing parties, 
and criticized Mr. Putin for not following the law.\textsuperscript{146} However, there is no hard evidence 
available to prove this role played by the Russian government and its enforcement 
authorities.

\textsuperscript{141} Ethan S. Burger & Mary S. Holland, “Law as Politics: The Russian Procuracy and Its Investigative 
\textsuperscript{142} Ibid. at 163.
\textsuperscript{143} Ibid.
\textsuperscript{144} “Russian Roulette - Current Investment Risks in Russia” Committee for Russian Economic Freedom 
(January 2010) at 2, online: Scribd <http://www.scribd.com/doc/25778254/Russian-Roulette-Current-
\textsuperscript{145} Yelina Kvurt, “Selective Prosecution in Russia - Myth or Reality?” (2007) 15:1 Cardozo J. of Int’l. and 
Comp. L. 127 at 132.
\textsuperscript{146} Supra note 142 at 1.
The Judicial System and Law Enforcement

The judicial system is also heavily affected by corruption. This can raise additional concerns for investors. Even though civil procedural legislation regulates civil actions quite effectively, judicial practice is very uneven and court decisions are often inconsistent with each other. While Russia does not follow the doctrine of precedent, this inconsistency makes it harder to predict the court’s position in a particular dispute. Courts rarely engage in deep theoretical analysis of legal norms while this type of analysis would be helpful later for business purposes. These factors make Russian courts incapable of contributing to the development of the legal system.

The rule of law in Russia, as well as the legal system in general, is undermined by poor law enforcement in the country. This problem is caused not only by corrupt practices, but also by the current poor condition of the entire law enforcement system. Currently the legal system is characterized by overburdened courts, underpaid judges and court personnel, and a generally low quality of legal education. There are other influential factors present as well. Evidence shows that “telephone justice” still appears to apply in some instances in Russia today. The concept of “telephone justice” originated during Soviet times and describes the situation where a judge is instructed over the phone by a top public official on how to rule on a particular case.¹⁴⁷ Although it is hard to prove there is evidence that comes from cases against judges for unethical behavior, testimonies of court officials confirming the influence of the government on the courts, as well as general agreement among legal professionals that there are always ways that can be found to influence a judge if needed. This suggests that, to a certain extent, such practices still take place today.¹⁴⁸ An unofficial price list exists for

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certain public actions. For example, the price for initiating a legal case against a competitor starts at $100,000, facilitation of the decision in an arbitration court starts at $50,000, and influencing a court decision relating to the confiscation of assets starts at $50,000.150

**Impact on Franchising**

Most of the above mentioned factors create environment that is obviously difficult for the development of franchise practice in Russia. However, this does not mean that new franchise regulation has no future in Russia. Though it may take a significant amount of time and effort to create the new regulation, and more time for market actors to adjust to its presence. The legislature may be opposed to introducing open-ended standards like the duty of good faith since such legal norms are uncommon in Russian legal practice. At the same time, the implementation of other norms such as disclosure requirements, or the right of franchisees to associate, is unlikely to encounter significant implementation problems. This is because their application can easily be sustained by the Russian legal system. Currently the Civil Code requires that the franchise agreement be registered with a federal governmental authority that deals with intellectual property. In order to better protect franchisees this requirement could be developed further. The requirement could be amended to also require the registration of a disclosure document with such an authority. This governmental body could be given the necessary powers to supervise the disclosure process and review franchisees’ complaints. In general, the application of new franchise regulation is unlikely to involve significant complications if it contains explicit rules that do not leave room for subjectivity or doubt.

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149 Ibid. at 278.
151 S. 1018.2 of the Civil Code.
In respect of a franchise business, the factors already outlined can clearly affect the efficacy of relations. However, it is not only franchising businesses that exist in such an environment. Corruption, poor law enforcement, and political influence affect many other businesses as well. Despite these factors businesses in Russia do survive and many thrive. Foreign investments still continue to flow into the Russian economy. Many foreign companies, including world-renowned franchisors, still operate in the Russian market. Companies like John Deere, Unilever, and HSBC recently began major expansions in Russia.\textsuperscript{152} Wal-Mart is also seeking to enter the Russian market.\textsuperscript{153} These companies are well aware of the complicated history of investment in Russia. The histories of such companies as BP, Royal Dutch Shell, Carrefour and Ikea in Russia are well known. This knowledge does not stop new companies from proceeding with their own investments. Companies that had legal proceedings initiated against them and/or their employees for bribing Russian officials include Hewlett-Packard,\textsuperscript{154} Daimler,\textsuperscript{155} and Siemens.\textsuperscript{156} This highlights the fact that many foreign companies in Russia, even prominent ones, do engage in bribery. Otherwise these companies run the risk of heavy administrative barriers being imposed on them.

However, there is no guarantee that investors will face these problems. Not every foreign company is forced to pay bribes to Russian officials. It is impossible to say beforehand

\begin{footnotes}
\item[152] Carol Matlack, “The Peril and Promise of Investing in Russia” Businessweek (September 24, 2009), online: Businessweek <http://www.businessweek.com/magazine/content/09_40/b4149048673765.htm>, last accessed July 16, 2010.
\end{footnotes}
whether a particular investment will be free to succeed or whether it will be tampered with. In any case, there are ways to confront these problems. If franchisors deal with large and sophisticated Russian parties then there should be fewer complications. Due to their size and business experience such Russian companies do care about their reputation and will try to solve a dispute before litigation. Further, they will acknowledge the authority of foreign arbitration and will most certainly comply with its results. With respect to the government authorities, it may be possible to find an intermediary company that can facilitate government relations. For better results a proper risk analysis should be undertaken before deciding whether or not to enter into the Russian market.

**Suggested Solutions**

One possible way to deal with the problem of corruption in the country would be to coordinate the activities of many foreign companies. These companies could commit to refusing to pay any bribes to officials. If they actually proceed with these intentions then they might be able to achieve positive results. The most important factors would be the number of companies and their real commitment. Unfortunately, there is a high probability that these companies will be faced with many new administrative requirements artificially created by government agencies. In confronting these artificial requirements companies could threaten to withdraw their investments from Russia. Their investments can act as significant leverage against the government. This will be especially effective if these companies have substantial influence on the market. If many companies are committed to this idea then the government would be unlikely to risk losing all of them. One such initiative was recently organized by Siemens AG, Deutsche Bank AG, Axel Springer AG,
Mercedes-Benz Russia, and a number of other German companies. The more foreign companies join this initiative the more effective it is likely to be.

Such coordinated activities are one of the very few ways of dealing with corruption in the country. Other methods of fighting corruption in Russia, like raising salaries, often prove to be ineffective. The main reason why corruption is so pervasive in the country is probably because Russian people are very passive. Starting from the middle centuries all of the country’s important matters were decided by the government, or by the single person heading the country. People trusted and depended on that one person, be it an emperor or a president. All misfortunes were left for that one person to solve. People did not participate in making decisions. They also did not challenge that person’s, or the government’s, decisions. This practice of relying on the government to make people’s lives better has continued for a very long time. Today people feel like they cannot do anything to solve the current problems of the country. People cannot influence the creation of true democracy in the country: when the government decides what is right the people will obey its decision. Due to the passiveness of the Russian people only the government is capable of solving its current problems and implementing democratic changes. However, the government’s actions can be significantly influenced by foreign nationals and companies. They can use the continuation of their investments in Russia as very effective leverage to force the government into changing its practices.

In the end, foreign investors should consider all these factors when entering into the Russian market. Factors such as corruption, poor law enforcement, and an inefficient legal system can influence the well-being of any business in the country. These factors can also affect the

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success of any new legal regulation. This, however, does not mean that current franchise legislation cannot be amended, or that foreign franchise businesses will not succeed. Even with current conditions franchising is still developing, and foreign companies still conduct business in the country. This, to a certain extent, proves that there are ways to handle the present problems in Russia.

**Conclusion**

Franchising presents a major opportunity for the growth and development of both small and established businesses. Small businesses benefit from the right to use an organized business system and established companies benefit from relatively easy and cost-effective expansion. These factors influence many companies to choose franchising as a form of business. Because franchising provides companies with favorable opportunities to make profits, a large number of companies engage in this business. This fact makes franchising very beneficial to a country’s economy. The positive effects of a franchise business increase further if it expands beyond the borders of one state. However, in order for the positive effects of franchising to be fully realized it needs to be regulated effectively. Effective regulation must be present both where the business is established and where it is expanding.

The current Russian market should be considered a viable option for international expansion. Many factors contribute to the likelihood that a foreign business will be profitable in Russia. An expanding market, a growing economy, and an increasingly wealthy population are some of these factors. However, while current economic factors can positively influence a decision to expand, a number of other factors play a potentially detrimental role. One such factor is the undeveloped state of franchising legislation, not to mention legislation in general. Despite the potential benefits that franchising can bring to the Russian economy its
legislative regulation is weak. Drafted in the 1990s it has yet to be amended. As such, it simply does not correspond to modern business standards. This slows the rate of growth of franchising practice in Russia today. At the same time, the example of developed countries shows how effective regulation can contribute to the success of a franchising system. North American jurisdictions, where franchising currently enjoys success, provide examples of effective regulation. These tested models could be applied by Russian theorists who wish to amend the ineffective Russian franchise legislation.

This thesis has provided an initial theoretical background for such an undertaking by providing a preliminary comparison of franchise regulation in one North American jurisdiction, Ontario, with that of Russia. Its aim was to derive an effective synthesis of legal norms from a comparison of two sets of legal norms. The hope is that this synthesis could contribute to the successful development of franchise practice in Russia. The research undertaken by this thesis looked at several important elements of franchising regulation in North America, discussed their practical application, and suggested ways in which these elements could be adapted to Russian franchise practices. The main finding of this thesis is that the legislative imposition of disclosure obligations on the franchisor is one of the most important factors that facilitate an effective franchise relationship. Mandatory disclosure of information deters possible violations of franchisees’ interests and allows the franchisee to make a more informed decision when acquiring a franchise. Introducing this requirement into Russian franchise regulation should be of the foremost priority for Russian legislators. Currently franchisees in Russia do not have effective legal instruments to protect their interests. Other elements of franchising in North American jurisdictions such as ADR mechanisms and the right of franchisees to associate should also be closely analyzed by Russian theorists. These elements can also significantly contribute to the effectiveness of the franchise relationship.
While franchising regulation in North American jurisdictions is generally effective it has a number of deficiencies. In Ontario these deficiencies affect franchisors’ interests and result in significant additional costs on their behalf. Complications such as the broad scope of several definitions in the Ontario Act, the absence of necessary clarifications for many of the terms within the Act, and the ambiguity of other terms, lower the efficiency of many franchise relationships in the province. An attempt was made to uncover the reasons for such problems and offer proposals for their resolution.

This research is intended to provide general direction for Russian theorists. Since Russian legal research generally lacks comparative analysis of franchising regulation in different jurisdictions, this thesis is an initial step in the development of effective franchise regulation in Russia. This research project provided an overview of some of the main elements of North American franchise regulation, with a preliminary analysis of their possible application to the Russian context. Due to the limited scope of the project only the more important elements were covered. A much broader range of the elements of North American franchise legislation should be evaluated in detail by Russian legislators during the process of transplantation. General common law concepts should also be closely reviewed, as many of them are required for the effective functioning of North American legislation, and in particular of franchising legislation. In the end, these extensive efforts could lead to the creation of a much more developed franchise practice in Russia.

Lastly, this thesis has tried to describe the general legal environment in Russia to the extent that it may affect foreign investors seeking to pursue franchise opportunities in Russia. A number of challenges face these foreign investors. The most serious of them are corruption and a generally undeveloped and inefficient judicial system. Extorted bribes, the possibility
of corporate raids, and rigged auctions can have a significant detrimental effect on any business in the country. However, despite these negative factors, investors should not be deterred from entering the Russian market. The possible benefits of having a business in Russia can be substantial. Additionally, examples of foreign companies that conduct business in Russia, as well as companies that wish to expand to the Russian market, illustrate that there is a general interest in this region. It further illustrates that there are ways to deal with the problems inherent in doing business in Russia. Together, these foreign companies could take a collective initiative in confronting corruption in the country. These companies have effective leverage and as such they could achieve substantial positive results. The combined effort of a number of international companies could be a significant step forward in making Russia a more attractive market for foreign investors.
APPENDIX I

Summary of Information that Needs to be Disclosed under the Ontario Act and Ontario Regulation

- The business background of the franchisor and its directors, general partners and officers;
- statements as prescribed, including detailed statements, in respect of those persons containing information on, inter alia, convictions of fraud within 10 years prior to the date of disclosure document, imposition of an administrative order or penalty, or findings of liability in a civil action of misrepresentation, unfair or deceptive business practices;
- details of any bankruptcy or insolvency proceedings, voluntary or otherwise, within preceding six years, against, inter alia, the franchisor, its associate, its directors, general partners, or officers in their personal capacity;
- franchisor’s financial statements as prescribed;
- copies of all agreements relating to the franchise to be signed by the franchisee;
- a description of any alternative resolution process, if used by the franchisor;
- a list of all the franchisee’s costs associated with the establishment and operation of the franchise;
- the description of any financing arrangements and assistance offered to franchisees;
- statements describing the advertising fund and franchisees’ contribution to it, if applicable;
- a description of granted exclusive territory or certain restrictions imposed by the franchise agreement;
• a description of the franchisor’s rights to commercial symbols associated with the franchise;
• a description of every authorization the franchisee is required to obtain to operate the franchise;
• the contact information of current and former franchisees, including the reasons for leaving in case of former franchisees;
• other information as prescribed; and
• any other material facts.
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