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Assignment of rights under franchising agreements in Kazakhstan



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The article dwells upon details of concluding franchising agreements in regard to assignment of rights to use trademarks and, in our opinion, will be of interest to both companies already operating in Kazakhstan and those that are just going to start their operations in this country.

Pursuant to Article 1.9 of the Law of the Republic of Kazakhstan No. 456-I dated July 26, 1999 On Trademarks, Service Marks and Appellations of Origin of Goods (hereinafter –the Law), the use of a trademark is the use of a trademark on goods and in the provision of services in respect of which it is protected, and (or) their packaging, production, use, import, storage, offer for sale, sale of goods with the designation of a trademark, use in signboards, advertising, printed materials or other business documents, as well as its other introduction into business. This definition is given in order to determine what in particular a trademark owner has the right to prohibit, and what action performed by the third party without a trademark owner’s consent can be considered a violation of his rights.

Everything listed in this article, and this is almost everything that is done with trademarks by the third party without a trademark owner's consent may be a violation. "Maybe" refers to a trademark owner's right not to prohibit its use, however further we refer to other issues.

Article 19.4 of the Law states: *"Evidence of the use of a trademark is considered to be its use on the goods for which it is registered, and (or) their packaging by a trademark owner or a person who has been granted such a right on the basis of an assignment agreement on the transfer of rights to a trademark in accordance with Article 21.2 of this Law. The use of a trademark includes production, import, storage, offer for sale, sale of goods with the designation of a trademark, its use in advertising, signboards, printed materials, on official letterheads, other business documents, transfer of the right to a trademark or when displaying goods on exhibitions held in the Republic of Kazakhstan, as well as their other introduction into business"*.

Article 1028 of the Civil Code of the Republic of Kazakhstan (hereinafter - the Civil Code of the Republic of Kazakhstan) also supports Article 19 of the Law and provides that "the conclusion of a license agreement for the use of a trademark is considered its use". This clearly and unconditionally indicates that a trademark owner having in fact a monopoly on the registered designation and the right to prohibit those listed in Article 1 of the Law of the action of the third parties, at the risk of cancellation of the registration of a trademark is obliged to use it on the product or its packaging or to enter into licensing agreements. Only these actions are direct evidence of the use of the trademark and other uses specified in Article 19 of the Law can only be recognized as evidence of use when considering a disputable situation.

In order to consider assignment of rights, first of all we should refer to

Article 1, taking into account the encumbrances that are transferred to the receiving party on the grounds of Article 19 of the Law and Article 1028 of the Civil Code of the Republic of Kazakhstan.

As can be seen from the above quote from Article 1028 of the Civil Code of the Republic of Kazakhstan, the right to use trademarks can be assigned either not to all rights, or not to all types of use, or in relation to not all classes in which a trademark is registered, or not for all goods listed in a specific class.

This right may be limited in time (for example, only from 2019 to 2022), there may be restrictions related to the territory.

The assignment of rights (if this is not a sale of a trademark) is carried out on the basis of an agreement on the provision of a complex license (franchise).

At the same time, as shown above, the very fact of concluding a franchising agreement even without use of a trademark for subsequent three years is already evidence of its use. However, if, after three years from the date of registration of the franchising agreement, a trademark is still not used by either its owner or the licensee (franchisee), then its registration may be cancelled.

The conclusion of another franchising agreement can be recommended in this case and a new three-year period of permissible non-use will begin.

The date of registration of a trademark is important as all registered property transactions must be registered, including a franchising agreement.

The need for registration in this case also provides certain requirements to the franchising agreement, even if this agreement is governed by foreign

law. However, the requirement to register the agreements is now under the dispute, since Kazakhstan joined the Singapore Treaty on the Law of Trademarks, according to which the fact of conclusion of agreements is registered and not the agreements themselves. However currently it is agreements that are being registered.

Such registration requires:

- translation of the franchise agreement into Kazakh and Russian languages;
- inclusion of the obligation of the franchisee to produce goods of a quality no worse than the goods of the franchisor;
- inclusion of the franchisor's right to control this quality;
- submission of materials for registration no later than six months from the date of signing an agreement.

Pursuant to the Singapore Treaty, if one of the parties is in a country that is a party to the Treaty, then the treaty can only be submitted in one language (Russian or Kazakh), and we hope that this provision will soon be applicable in Kazakhstan. At the same time, if an agreement is concluded between two Kazakhstanis and despite the fact that both of these parties are formally located on the territory of a country that is a member of the Singapore Treaty, the Law No. 151-I of the Republic of Kazakhstan dated July 11, 1997 On Languages in the Republic of Kazakhstan is applied and the agreement should be prepared in both Kazakh and Russian languages. This conflict between the prevailing international treaty and the requirements of national legislation and language policy must be resolved. A franchise agreement is valid from the date of its registration, and, for example, royalties for previous periods (most often from the date of the conclusion of the agreement until the date of its registration) should not be

made.

Unlike a license agreement, a significant issue when concluding a franchise agreement is the need to prepare and register it in accordance with the rules for preparing and registering a license agreement. The latter, as required by the legislation of Kazakhstan, should relate to one object, for example, only to a trademark or patent for an invention, while under a franchise agreement, a set of rights related to any objects can be transferred. This contradiction technically prevents the conclusion of a franchise agreement, but, unfortunately, changes in legislation that could help in overcoming it are not foreseen. In such conditions, we recommend concluding a franchise agreement containing only one registered intellectual property object, and transferring other objects on the basis of separate license agreements each of which refers to one of such objects.

The following should be also taken into account. A franchise agreement is assumed to be paid for, however it may be free of charge if such agreement clearly provides that no royalties are charged for the use of a trademark. Tax issues are also refer to this provision, in particular: free of charge franchise agreement implies that the franchisee receives property rights without any counter-obligations to the franchisor.

Pursuant to the Tax Code of the Republic of Kazakhstan, the total annual income includes all types of taxpayer's income, including property received free of charge, works performed and services provided. At the same time, the cost of property received free of charge is determined according to accounting data in accordance with international financial reporting standards and the requirements of the legislation of Kazakhstan on accounting and financial reporting.

The Tax Code does not provide for the procedure for assessing the value of

property rights received free of charge. However, we believe that when evaluating property rights, the principle of determining income when receiving property free of charge, which consists in evaluating it based on market prices can be applied.

Consequently, when the right to use a trademark is obtained free of charge, non-sale income includes income in the form of the free right to use property, determined on the basis of market prices for the use of similar rights.

The above is undoubtedly applicable to both foreign companies and Kazakh companies. However our more than 20 years of experience in the field of IP protection shows; it is foreign companies that come to the Kazakhstan market and very often:

- do not have valid and sufficient trademark registrations for operating in Kazakhstan, or these registrations are insufficient in terms of the number of trademarks, their writing in Cyrillic, the specified classes or goods. Registration in other countries in most cases does not matter for operation of a foreign company in Kazakhstan;
- draft franchising agreements and do not register them, or enter into distribution or dealership agreements, believing that they are sufficient, however it is not;
- start paying royalties without establishing proper cooperation with their Kazakh partners and by this violating the tax legislation of Kazakhstan;
- try to use their rights to trademarks that are not available or are essentially insufficient, from which they endanger their own business and the business of those who are associated with them.

We recommend to companies operating in Kazakhstan or those who are just going to start working here:

- conduct appropriate searches for the presence of registered own trademarks or, especially if they are not registered, for the presence of registrations of these (or confusingly similar) trademarks in the name of the third parties, in particular, their dealers or distributors, other counterparties or partners in business;
- finish registration of the necessary intellectual property rights, in particular, trademarks;
- fix all drawbacks of existing registrations;
- prepare, conclude and register licensing agreements;
- calculate and pay royalties, include royalties in the customs value of goods; and
- monitor the market and protect appropriate rights.

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