



Non-competition clauses survive and remain enforceable after termination of a franchise agreement. What about license agreements?

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A non-competition clause is a special restriction limiting a business activity voluntarily assumed by a party towards the other party after termination of an agreement. It is quite usual in franchise agreements. It provides additional protection of IP rights, once the contractual obligations are no longer applicable. The concept may look straightforward enough, but in situations of conflict between the right-holder and the franchisee, non-competition clauses may become uncertain and potentially at the source of litigation.

The Supreme Court of the Russian Federation recently concerned itself with the subject in case A71-13420/2020, and issued its decision on 09 June 2022 on the claims of a franchisee challenging the validity of a non-competition clause after termination of the agreement. More particularly, the assessment of the Supreme Court addressed the penalty

claims of a franchisor originated by the continuation of a competing activity after termination of the agreement by a person affiliated with the franchisee, as well as the counter-claim of the defendant seeking a finding of nullity of the relevant non-competition clause. The first instance court had rejected both claims and counter-claims, and the appeal and cassation courts upheld the first instance judgment. As a result, the Supreme Court as the highest instance of jurisdiction was revising the case.

The non-competition clause of the agreement under dispute foresaw the obligation of the franchisee to refrain from competing actions during the term of the agreement and three years after the termination thereof, and the right of the right-holder to terminate the agreement in case of breach by the franchisee of the non-competition obligation. The contract also contemplated a penalty in the amount of 1 million Rubles (about Euro 16 000) for



any unlawfully competing action, performed by the franchisee or its affiliates.

The courts of first, appeal and cassation instances had found that the agreement had been unilaterally terminated before claims of breach of the non-competition clause and for payment of the penalty were filed. Based on the fact that the agreement was then no longer in force, all courts had rejected the claims of the right-holder.

The Supreme Court referred first to the general legal regime of franchise agreements, in particular, to the provision of article 1033 of the Civil Code whereby the parties may consensually agree on some restrictions of their rights. In particular, the law expressly contemplates among permissible restrictions the assumption of the obligation of the right-holder to refrain from granting similar rights to other parties, or the obligation of the franchisee not to compete with the right-holder by engaging in a business activity similar to that covered by the franchise agreement.

The Supreme Court furthermore referred to item 3 of Resolution no.35 dated 06 June 2014 of the Supreme Arbitration Court of the Russian Federation. That item explained the enforcement mechanics of part 2 of article 453 of the Civil Code, which provides that the obligations of the parties cease to exist upon termination of the agreement, unless otherwise prescribed by law, the agreement itself or pursuant to the core – that is, the very intrinsic nature - of the obligation. The Supreme Court clarified that, by its Resolution, the Supreme Arbitration Court had confirmed that the termination of a contract released the debtor from the obligation which was the subject of the contract. However, the same Resolution specified that the terms and conditions of the contract governing post-agreement relations, or those applicable after termination, remained in full force and effect unless otherwise agreed by the parties. Since security measures provided for in the contract (such as a contractual penalty) are accessory to and follow the destiny of the main obligation, if the main obligation

remains in force upon termination, then the security provision equally survives.

Based on the facts of the case, the Supreme Court found that the franchise agreement contained a clause aimed at governing the relations of the parties after termination of their agreement, namely, the non-competition obligation of the franchisee. This obligation was expressed to be valid for a term of three years after termination of the contract, so the parties had intended the clause to survive such termination. Furthermore, the Supreme Court adjudged the penalty clause, which was referred to within the non-competition clause, also valid and applicable, as it secured the main obligation, which had not come to an end with the termination of the franchise agreement.

As a result, the Supreme Court set aside in part the decisions of the lower courts and ordered the retrial of the case by the first instance court. The penalty claim of the right-holder because of the opening of a competing activity by a person affiliated with the franchisee was, though, rejected as the claimant had failed to prove the affiliation between that person and the franchisee.

On 29 August 2022 the first instance court issued on remand a revised decision and granted claim of the right-holder for payment of the penalty for breach of the non-competition clause contained in the franchise agreement.

One may wonder if the above conclusions of the Supreme Court are applicable to the validity of non-competition clauses included in an intellectual property license agreement, but this is not the case. Let us see why.

Both license and franchise agreements share the feature of granting rights to use the IP object of a contract only for the term of the latter. Once the relevant contract terminates, the licensee/franchisee must discontinue the use of the IP rights of the right-holder. The unlawful continuing use of such IP rights by the licensee/franchisee after the contract expiration or termination hence constitutes an infringement, and Russian

law provides the right-holder with a number of statutory remedies – namely, seeking a judicial order to desist from the infringement and seeking payment of compensation therefor.

However, this provision does not cover a situation where the former licensee/franchisee does not unlawfully use IP rights, but rather continues to unduly use the competences and experiences developed during the term of the agreement, for building up and/or continuing to engage in its own business on the same market. That is the case of a negative obligation such as that contained in a non-competition clause expressly obliging the licensee/franchisee to refrain from being active on the same market as a business rival.

Article 1033 of the Civil Code previously mentioned, which provides for the parties' option to agree on contractual restrictions, including a non-competition clause only addresses franchise agreements and does not cover intellectual property license agreements. Based on the general principle of contractual freedom set out in part 4 article 421 of the Civil Code, the parties are at liberty to agree the terms and conditions of the contract they make unless otherwise prescribed by Russian law.

The provisions of Part 4 of the Civil Code that govern intellectual property license agreement set mandatory terms and conditions for such agreements, but without prejudice to any other provisions. Accordingly, there seems to be no legal prohibition to insert a non-competition clause in a license agreement.

It should, though, be noted that the concepts of license and franchise agreement present significant differences, and this may end up at the source of an extent of legal uncertainty.

According to article 1235 of the Civil Code, an IP right holder may grant or undertake to grant to another party the right to use its right on the terms

provided for in a license agreement. A trademark license agreement is a particular case of IP license. As provided by article 1489 of the Civil Code it consists of the grant of the right to use a trademark on the terms of the agreement for all or part of protected goods and optionally specifying the territory of use.

Conversely, a franchise agreement, according to article 1027 of the Civil Code, mandatorily foresees the grant of a bundle of IP rights, including trademark and other rights, in particular, the right to a commercial name and know-how for use in a business activity, for a consideration. That same article provides that the rules of Section 7 of the Civil Code (on IP rights) relative to license agreements are also applicable to franchise agreements, unless this is contrary to more specific provisions applicable to the latter. Since a franchise agreement is a special case of IP license, the special rules applicable to the former prevail over the general provisions, and as a result do not apply to license agreements.

In other words, the legislator did not bind the rationale for a non-competition obligation to a trademark license, but to other information and rights typically provided for in the franchise agreement. The licensee holds only the right to use an IP right, e.g. a trademark, and is not supposed to obtain any additional information about the business activity of the right-holder. For that reason, it makes sense that he could not enjoy a competitive advantage after the termination of the license.


Based on the contractual freedom principle and the provisions of item 3 of Resolution no.35 dated 06 June 2014 previously mentioned, a non-competition clause included in a license agreement should also be valid after termination of the license, but it is not yet clear if the Russian courts will concur with reconstruction in real life, when seized of a dispute similar to that adjudged on remand in the recent case we reported on.




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