

Chapter 21

GEORGIA

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I INTRODUCTION

The development of franchising in Georgia started in the mid-nineties, marked by the establishment of the first McDonald's restaurant in the capital, Tbilisi, which preceded the introduction of the franchise-specific regulation now found in the Georgian Civil Code, adopted in 1997.

Franchising had a new beginning a decade ago, when the local economy started to experience sustainable growth and the overall business environment began to improve. Since then, a number of international franchises have been gradually growing in all possible sectors including, food and beverage retail, hospitality etc. The influx of tourists and visitors in recent years created the necessity for an appropriate infrastructure, notably in the Black Sea resorts. As a result, international hotel brands which are currently present include Radisson, Sheraton, Holiday Inn and Marriott, with planned opening of Hilton and Kempinski.²

Nearly all entrants are established United States or European brands. Unfortunately, local franchisors are virtually non-existent. At the same time, certain local brands, notably in the retail and food and beverage sectors, have grown to a point where possible expansion via franchising cannot be overruled in the foreseeable future.

Despite its small market (both in terms of the size and purchasing power of the population), Georgia offers international brands a sound business environment in general as well as the flexible, franchisor friendly laws to structure their deals.³ Unlike

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2 Some of these hotel brands may be operating under hotel management agreements.

3 The annual Doing Business report, published by the World Bank and the International Finance Corporation, ranked Georgia ninth in the world for ease of doing business in 2013.

mature western markets, international brands have good opportunities to expand their business in a less competitive but growing economy.

Unfortunately there are no official statistics or governmental reports keeping record of franchise-related data in the country. Likewise, the establishment of franchising associations or similar organisations are still on the agenda.

II MARKET ENTRY

i Restrictions

Foreign franchisors do not face any legal restrictions when entering the Georgian market. That includes granting master franchise or development rights to a local entity. In fact, for area development arrangements which often cover the entire south Caucasus region (Georgia, Armenia, Azerbaijan), it is advantageous to ask the franchisee to incorporate a Georgian entity as master franchisee or area developer, since Georgia provides a sound legal system with no obstacles to enforcement and may generally be regarded as a stable and neutral place from which to operate in all three countries simultaneously.⁴

Foreign legal and natural persons may freely participate in the equity of a Georgian company or own real property in the country.⁵

ii Foreign exchange and tax

A foreign investor or entity (after payment of taxes and other charges) is entitled to convert income and funds from local to the preferred currency at the market exchange rate at banks in Georgia, and repatriate the foreign currency without any limitation. The types of income and funds include any profit, dividend or assets after the sale; proceeds from use of intellectual property rights such as royalties and franchise or service fees and payments relating to contractual obligations.

Every legal and natural person within Georgia is obligated to calculate, announce, charge and make payments for goods and services exclusively in the national currency, the Georgian lari. However, payments for import-export related transactions (including payment of franchise fees) made offshore can be denominated and paid in any currency chosen by the parties. Offshore payments relating to such activities can be made directly into offshore accounts, subject to a resident entity presenting the bank with the reasons for a foreign currency transfer (e.g., referring to the existence of the franchise agreement).

There are no other reporting requirements. Both resident and non-resident legal entities are entitled to withdraw funds from their accounts and transfer an unlimited amount abroad.

It is not necessary for a foreign franchisor to establish a local presence in Georgia. In practice, most franchisors choose not to set up a local entity. Therefore, franchise fees paid to a foreign franchisor are subject to withholding tax at 10 per cent unless the applicable domestic tariff area (DTA) provides for some exemptions or favourable

⁴ Due to political tensions between neighbouring Armenia and Azerbaijan.

⁵ A temporary restriction with respect to the ownership of agricultural land by foreigners is expected to be lifted soon.

tax treatment. Favourable DTAs exist with a number of countries including France, Germany, the United Kingdom and the Netherlands.

III INTELLECTUAL PROPERTY

i Brand search

Any interested party may apply and obtain information on the trademarks registered in Georgia from the Georgian Intellectual Property Centre. Searches are also available in the online database of the Georgian Intellectual Property Centre. It is usually best to use local lawyers or patent attorneys to handle these searches and advise on potential conflicts.

ii Brand protection

The Law of Georgia on Trademarks regulates issues related to trademarks, rights of trademark owners, registration of trademarks and their transfer and license. Under this law, a trademark is defined as a sign or combination of signs (words, letters, figures, sounds, a design including shape of goods or their packaging, etc.) that may be represented graphically and is capable of distinguishing the goods, services or both of one undertaking from those of other undertakings.

Registration of the trademarks does not represent a precondition to selling a franchise in Georgia, but since the owner may avail itself of the rights and protections granted under the Georgian Trademark Law only after the trademark registration, it is recommended that the relevant trademark is registered before or shortly after conclusion of the franchise agreement. Trademark registration generally takes up to one year from the date of application, but an accelerated procedure is available against payment of an acceleration fee of US\$850. Under the accelerated procedure, registration takes only 10 days provided there are no queries or registration obstacles.

Georgia uses the unique Georgian script, so registration of a transliterated mark may be considered. There is also a new requirement to display the mark in local lettering on all advertising (explained in the last section of this chapter).

Any natural or legal person may obtain an exclusive right to a trademark by registering it with the Georgian Intellectual Property Centre. The trademark holder's **exclusive right** is effective as from the date of registration, and entitles the latter to enjoy **exclusive rights** to the trademark and prevent third parties from using the trademark in the course of trade that is:

- a* identical to the protected trademark and related to the same goods;
- b* identical to the protected trademark and with goods so similar that there is a risk of confusion, including confusion based on association;
- c* similar to the protected trademark, where the goods are identical or so similar that there is a risk of confusion of the trademarks, including confusion based on association;
- d* identical or similar to the protected trademark, and protected on account of the good reputation of the trademark in Georgia, so that the use of the trademark affords unfair advantages to third parties or damages the good reputation of the trademark or its distinguishing power.

Without first obtaining the relevant consent of the trademark holder, any third party is prohibited (1) from affixing a sign identical or similar to the trademark on packaging materials, labels, tags, etc.; and (2) from offering, placing on the market, selling, preparing for sale, importing or exporting packaging material or packaging bearing the trademark.

Trademarks may be registered with the Georgian Intellectual Property Centre, either in accordance with ordinary or accelerated proceedings. Priority is based on the application for registration. Under both proceedings, a trademark application undergoes examination as to form as well as substantive examination and is followed by the trademark's publication, its registration and issuance of the trademark certificate.

Trademarks are registered for 10 years following their registration date. Registration is renewable for consecutive 10-year terms.

iii Enforcement

In case of infringement, the trademark holder can enforce its exclusive rights under the Trademark Law against the third party through court proceedings. Injunctions are available in trademark cases. Action can also be taken against a franchisee or licensee if the infringement relates to incorrect use of the trademarks by the franchisee. For example, this would be the case if the franchisee applied the trademark to unauthorised goods or sold the products outside the territory in which the trademark may be used. The franchisee may bring an infringement action only with the consent of the trademark owner. The franchisee is, however, entitled to participate in court proceedings for infringement of the licensed trademark rights in order to secure its right to claim damages from the infringing party. This impacts on the usual trademark defence clauses found in international franchise agreements in that it would not be possible to locally enforce the proviso by which the franchisee has no right to participate in trademark proceeding except at the request of the franchisor.

iv Data protection, cybercrime, social media and e-commerce

The Georgian Law on Personal Data Protection was adopted in 2011. The law regulates issues related to management of personal data, information disclosure, modes of data processing, rights of the data processor, administrative sanctions applicable in case of violation of the statutory requirements, etc. Normally, processing of personal data is subject to express consent by the data subjects. If franchisees process personal data, statutory procedures and requirements must be complied with including obtaining consent from data subjects.

IV FRANCHISE LAW

i Legislation

The Georgian Civil Code contains a separate chapter on franchising. Franchising is defined as 'a long-term contractual relationship under which independent businesses are bilaterally bound, as far as necessary, to promote the production and marketing of goods and rendering of services by performing specific obligations'.

The statutory provisions are relatively brief. They are mostly not mandatory in nature, and can therefore be varied in different franchise agreements. They are seen

as setting minimum standards for franchise agreements, and may be modified or supplemented in individual agreements between private contracting parties. The main points covered by the law concern:

- a* obligations of the parties;
- b* duration of the contract; and
- c* requirements of form and content.

These are outlined below.

Obligations of the franchisor

The franchisor is under an obligation to license certain intellectual property rights to the franchisee. These have to be licenced in the same form in which the franchisor uses them. This covers:

- a* trademarks and trade names;
- b* samples and packaging;
- c* the knowhow of the franchisor regarding items such as the methods of management, production, purchase and marketing of the goods;
- d* other information required for promotion of sales.

The franchisor also has an obligation to protect the franchisee's operation from intervention by third persons, to develop it consistently, and to support the franchisee by sharing business skills and furnishing information and training.

Obligations of the franchisee

A franchisee, in turn, is obligated to pay the franchise fee. Without agreement to the contrary, the amount of the fee is calculated by taking into account the contribution made by the franchisor to the implementation of the franchise system.

The franchisee also has an obligation to actively conduct the business with due diligence, to purchase goods through the franchiser or through persons named by the franchiser and not to disclose confidential information.

The duration of the franchise contract may be freely determined by the parties, taking into consideration the requirements for marketing the given goods and services.

The law further stipulates that after expiration of the contract the parties must act fairly when competing with each other. This is generally understood to mean that the franchisee may be prohibited from competing with the franchisor within a specified area for a period of time, not to exceed one year.

Validity of a franchise contract requires that it be in written form. Further, to be valid the contract must have a certain minimum content. The contract needs to clearly set out the rights and obligations of the parties, the term, provisions on termination or extension of the contract, description of the system of the franchise and any other terms parties deem essential and appropriate.

ii Pre-contractual disclosure

There is a statutory duty of pre-contractual disclosure set out in the Georgian Franchise Law.

The Law provides, in general terms, that at the time of execution of the contract parties must duly inform each other about the circumstances relating to the franchise, especially the system of the franchise, and communicate the information to each other in good faith. There are no specific disclosure items detailed in the Law and there are no additional requirements relating to the format and content of disclosure, nor is there a minimum number of days stipulated that must expire before signing or payment. However, the general pre-contractual duty of disclosure is understood to impose an obligation on the franchisor to disclose to the franchisee all material facts relating to the franchise system. Failure to make full disclosure may result in claims for misrepresentation and termination of the contract.

iii Registration

There are no franchise registration laws.

iv Mandatory clauses

The provisions of the Franchise Law are considered non-mandatory and therefore may be contracted by express agreement of the parties. In the absence of an express contractual agreement between the parties with respect to a matter covered by the Law, the relevant statutory regulations will take effect and become an implied term of the contract.

Statutory provisions feature basic descriptive regulations that are considered essential for a relevant legal relationship to be considered as franchising with the meaning of the Civil Code. Effectively this means that they operate as mandatory law when the contract is silent. Accordingly, the franchisor has to ensure that the franchise agreement covers these issues, as otherwise the statutory position will be implied.

The implied provisions are:

- a* obligation of the franchisor to license to the franchisee intangible property rights, trademarks and trade names, concepts of management and other information required for promotion of sale;
- b* obligation of the franchisor to consistently develop the system and to support the franchisee by sharing business skills and furnishing information and training;
- c* obligation of franchisee to pay the franchise fee;
- d* obligation of both parties not to disclose the information confided to them, even if the agreement is not executed; and
- e* requirement of the written form.

v Guarantees and protection

In terms of guaranteeing payment or other obligations of the franchisee, both guarantees (i.e., bank guarantees) and other types of securities, particularly the suretyship, may be used. Security can be given by legal or natural persons. The guarantor may be the owner of the franchisee entity, or a third party such as a high net worth individual.

V TAX

i Franchisor tax liabilities

Unless a foreign franchisor specifically establishes a corporate presence in Georgia, the conclusion of a franchise contract and the underlining activities do not create a permanent establishment for a foreign franchisor in Georgia.

When the non-resident franchisor derives income from sources in Georgia, in the form of a franchisee fee, tax is generally required to be withheld at the source. The applicable withholding tax rate is 10 per cent. The local franchisee is also obliged to apply reverse-charge VAT (VAT will be recovered or credited by the franchisee).

The Georgian taxpayer, i.e. the local franchisee, is obliged to deduct withholding tax from its payments to the non-resident franchisor.

ii Franchisee tax liabilities

Corporate income tax is charged on the profits earned by a Georgian enterprise, including a local franchisee (and foreign enterprises carrying out their activities through a permanent establishment in Georgia), at a flat rate of 15 per cent.

Dividends distributed by Georgian companies to a natural person or a foreign enterprise are subject to 5 per cent withholding tax at the source of payment, unless in the case of a non-resident a relevant tax treaty stipulates otherwise. Dividends paid to Georgian enterprises are not taxed at the source of payment.

The VAT rate is 18 per cent.

iii Tax-efficient structures

If a person otherwise subject to withholding tax (a foreign franchisor with no permanent establishment) is resident in a jurisdiction with which Georgia has concluded a double taxation treaty, the withholding tax that would otherwise apply may be reduced or eliminated pursuant to the treaty.

Georgia has signed and ratified DTAs with more than 30 countries. In each case, it should be considered whether the country of the franchisor has a DTA with Georgia that may allow for favourable tax treatment. These countries include France, Germany, the United Kingdom and the Netherlands.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The principle of good faith is recognised by Georgian law and applies to both franchisor and franchisee. Statutory provisions referring to the principle of good faith are found in the chapter of the Civil Code regulating franchising, as well as in the general law of obligations.

The principle of good faith extends to pre-contractual relationships as well as to the manner of performance of obligations and to the dispute resolution mechanisms and rights of termination. The principle of good faith impacts on the duty of pre-contractual disclosure in that it requires the franchisor to disclose to the franchisee all material facts regarding the franchise system prior to the execution of the franchise agreement.

Failure to disclosure material facts can give the franchisee the right to claim damages or terminate the contract.

ii Agency distributor model

There is no agency-related regulation in Georgia and, in the absence of such, no similar provisions can be applied by analogy. At the same time, it should be noted that Georgian franchising legislation provides for the possibility of compensation payments to the franchisee in certain instances (after termination).

iii Employment law

Franchising is defined as a long-term relationship between independent businesses. That implies that the franchisee is an independent entrepreneur who is being granted certain liberties in conducting its business activities.

However, Georgian case law is silent on whether a franchisee who is closely supervised and controlled by the franchisor could claim to be an employee, and therefore the risk that closely controlled franchising may be treated as employment is remote.

iv Consumer protection

Franchisees are not regarded as consumers, and there is no statutory ground or court practice that proves that there is a risk that franchisees may be treated as such.

v Competition law

Georgian competition law is underdeveloped. Currently the Law on Free Trade and Competition prohibits basic anti-competitive behaviours such as abuse of dominant market position, vertical and horizontal restraints and cartels. Theoretically, franchise agreements contain vertical constraints. However, the enforcement of Georgian competition law is particularly weak and virtually non-existent. Therefore, the practical approach of the competition authorities to purchase ties in franchise agreements, or to resale price maintenance is unknown. No sanctions have ever been applied in respect to similar arrangements.

There have recently been calls for the reformation of competition law. Relevant developments in this respect remain to be seen.

vi Restrictive covenants

During the term of the franchise agreement, the franchisee can be prevented from competing with the franchisor and its other franchisees. Even after the expiry of the franchise agreement, the parties are under a statutory obligation to not compete with each other unfairly. This is generally understood to mean that the franchisee may be prohibited from competing with the franchisor within a specified area for a period of time, not to exceed one year.

If the prohibition of competition may endanger the professional business of the franchisee, when the franchisee agrees not to compete after termination, then the franchisee may be entitled to reasonable monetary compensation.

vii Termination

Under Georgian Law, the franchise agreement is regarded as a long-term contractual relationship. The franchisor may, on legitimate grounds, terminate a long-term contractual relationship such as franchising before the expiry of the agreed fixed term. Grounds are legitimate when, taking into account the specific situation including force majeure and mutual interests, an early termination is justified. Grounds for termination include breach of material contractual obligations, but a reasonable opportunity to remedy the situation must first be given. A cure period should therefore be set out in the franchise agreement, but if the contract is silent on this point the law will imply a reasonable cure period. It is typically best to allow time for cure prior to proceeding with termination unless it is obvious that giving additional time will yield no results. Once the prescribed cure period has expired without the breach being cured, the franchisor may terminate the agreement by written notice. It should also be noted that the franchisee will have a defence against termination, if the breach is fully or principally attributable to the franchisor. This could be the case if the franchisee had not operated the business to the required standards but was able to show that this due to the failure of the franchisor to provide proper training and support.

As stated above, the law allows restrictive covenants regarding non-competition to be agreed by the parties. As stated, if such covenant may endanger the professional business of the franchisee, then the franchisee will be entitled to reasonable monetary compensation.

Some franchise agreements give the franchisor the option to require the franchisee to transfer the lease for the premises of the franchise business to the franchisor or its nominee on termination. The assignment of a lease agreement is possible in Georgia as Georgian law recognises contracts for the benefit of third parties. Ideally, the franchisor should also be a signatory to the initial lease agreement (along with franchisee and lessor) to expressly establish the right of assignment. Long-term leases are subject to registration with the Public Registry of the Ministry of Justice, so in that case the rights of the franchisor would have to be registered.

Other tools used by franchisors to ensure the longevity of the local business after termination, such as a buy you option, are legally possible under Georgian law but may be difficult to enforce in practice. A pledge and retention of the shares in the franchisee company may be taken to secure the franchisee's respective commitment.

viii Anti-corruption and anti-terrorism regulation

With regard to the acceptance of 'gifts', anti-corruption legislation imposes specific requirements on public officials which are broadly defined and interpreted and cover any valuable item, property, provision of services, full or partial release from some monetary obligation, etc. if they exceed established monetary thresholds (which are minimal).

Violation of such rules would bring about legal consequences such as imposition of disciplinary sanctions or dismissal, unless the gift can be established as a bribe, which represents a criminal offence and may result in criminal sanctions for the parties involved (i.e., bribe-giver and bribe-taker).

If the franchisee gave a bribe without the knowledge of the franchisor, the franchisor would not typically be held responsible for this, unless the franchisor and franchisee acted in concert.

ix Dispute resolution

Since most, if not all, franchises in Georgia are granted by foreign franchisors, respective agreements normally envisage foreign (non-Georgian) fora or international arbitration as dispute settlement venues.

Georgian private international law allows forum shopping, but provides that foreign court judgments will not be enforced if, *inter alia*:

- a* the case falls within the exclusive jurisdiction of the Georgian courts (such as cases concerning immovable property located in Georgia);
- b* the foreign country has not recognised decisions by a court of Georgia when given the opportunity in the past; and
- c* a decision contradicts certain major legal principles of Georgia, such as the right to due summons and other procedural protections.

Franchise agreements do not normally concern immovable property, but care must be taken if the franchise contains an option over a registered lease. Typically, lack of reciprocity can be an obstacle to enforcement.

Georgia acceded to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards in May 1994. In accordance with the New York Convention, Georgia recognises foreign arbitral awards as binding and enforces these awards in its courts. Recognition and enforcement of foreign court decisions (notably in the United States and the United Kingdom) and arbitration awards have, in fact, become quite established practices.

Mediation is recognised but not practiced widely. Injunctions are available and may be indispensable for franchisors against trademark infringements by former franchisees or other third parties.

Private International Law confirms that the parties to a contract may choose the law of either one of their countries of organisation or a third country to govern the interpretation of their contract. Contractual choice of law provisions will not be honoured if the question relates to certain major legal principles of Georgia. The legal concepts underlying the aforementioned major legal principles are considered imperative norms of Georgian law.

Contractual penalties are enforceable, *inter alia*, for breach of restrictive covenants, provided they are reasonable. If this is not the case, courts are entitled to decrease the amount of penalty payable in specific cases. The underlying principle of compensation is that a party responsible for damages must restore the state of affairs that would have existed if the circumstances giving rise to the duty to compensate had not occurred. If restoration of the original state of affairs is impossible, then monetary compensation may be granted. Damages are normally compensation for actual loss, but may extend to a lost profit. In the context of franchising, damages may include repayment of franchise fees and wasted investment cost.

A handful of local law firms provide franchise-related advice and assistance in litigation, notably in the context of international franchising. Court fees are calculated on the basis of a fixed percentage of the value of the dispute, and the losing party is responsible for those fees. Attorney fees may be recovered from the losing party subject to application of the statutory cap – which is again a certain percentage of the value of the respective claim.

VII CURRENT DEVELOPMENTS

Recent amendments to the Advertising Law require transliteration (using Georgian script of at least same size) of trademarks appearing not only in commercials and advertisements but also on shop fronts. Local business community and trademark owners argue that this requirement is not only costly but also conflicts with the marketing policy of many international companies since the value and popularity of brands, for which companies invest, is based on their original appearance and design in Latin letters. Moreover, often brands are not made up of standard letters and sign but rather styled elements and graphic representation to create and represent logotypes. Lobbying activities by the business community are ongoing with the aim to achieve desirable amendments to the legislation.

Appendix 1

ABOUT THE AUTHORS

MIKHEIL GOGESHVILI

MKD

Mikheil Gogeshvili is a lawyer practising in MKD law firm since 2002. Mr Gogeshvili's practice is concentrated on corporate law, M&A, contract and commercial law. Mikheil has been involved in various international and cross-border transactions and advised many international franchisors establishing their presence in Georgia in various sectors, such as retail, services, F&B. He speaks Georgian, English and Russian.

BABETTE MÄRZHEUSER-WOOD

Dentons

Babette heads up the EMEA franchise group at Dentons. She has more than 20 years' experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe's leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by *Chambers Global* as one of the top 10 franchise specialists in the world. She is also recommended by *The International Who's Who of Franchise Lawyers*, *Chambers UK* and *Legal 500* for her franchise expertise. Babette's research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of *The Franchise Law Review*. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.

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