Jelena Perović

University of Belgrade
Faculty of Economics
Department of Business Economics
and Management

HOW TO SECURE CONTRACT PERFORMANCE? DISTRIBUTION, FRANCHISE AND FINANCIAL LEASING IN SERBIAN LAW

Kako obezbediti izvršenje ugovora?
Distribucija, franšizing i finansijski lizing u srpskom
pravu

Abstract

Subject of the article is the analyses of the selected critical issues regarding performance of franchising, distribution and financial leasing in the light of recent developments in Serbian contract law. After adoption of the Law on Financial Leasing and preparation of the Draft Civil Code of Serbia which includes the rules on franchising and distribution, the legal framework of these transactions is much better shaped than is used to be. The article examines the main rules on determination, content and form of these contracts, the principal obligations of the parties and the grounds for contract termination as well as the crucial issues regarding applicable law and dispute resolution and suggests to contracting parties the optimal solutions to secure the contract performance.

Key words: *franchising, distribution, financial leasing, contract, rules*

Sažetak

Predmet rada predstavlja analiza pojedinih spornih pitanja u pogledu izvršenja ugovora o franšizingu, distribuciji i finansijskom lizingu. Analiza je izvršena u svetlu novijeg razvoja srpskog ugovornog prava. Usvajanje Zakona o finansijskom lizingu i priprema nacrtu Građanskog zakonika Srbije koji obuhvata i rešenja o franšizingu i distribuciji, predstavljaju značajne korake u unapređenju pravila koja prate pomenute privredne ugovore. U radu se ispituju pravila koja se odnose na određenje, sadržinu i formu pomenutih ugovora, najznačajnije obaveze ugovornih strana, osnovi za raskid ugovora, kao i osnovna pitanja u pogledu merodavnog prava i rešavanja sporova i sugerišu se optimalna rešenja za obezbeđenje uspešnog izvršenja ugovora.

Ključne reči: *franšizing, distribucija, finansijski lizing, ugovor, pravila*

General introduction

The key aspect of the success of business transactions is the quality of the contracts concluded. Rules on negotiating and drafting a contract are essential for commercial dispute prevention; had the contract been better drafted the relationship between the parties could have been better preserved and developed. In Serbian legal system the majority of contracts are regulated by the Law on Obligations. The rules of the Law on Obligations are mostly of non-mandatory nature, meaning that the Law, for the most part, allows the parties to regulate their contractual relationship in accordance with the principle of party autonomy. On the other hand, there are certain commercial contracts not regulated by law (the so-called modern contracts) which, according to the principle of party autonomy, can be validly concluded, subject to requirements of public policy, mandatory rules and good trade usages. These contracts, resulting from the needs of contemporary business transactions, could not have been encompassed by the Law on Obligations as they had not been common, or even known, at the time the Law was adopted. Thus, for example, in Serbian legal system, distribution, franchise, factoring, forfeiting

and some other modern contracts are not regulated by law despite the fact they are quite usual in commercial transactions. On the other hand, financial leasing is regulated by the recently adopted special law but the jurisprudence in that field is not developed yet. Why and what to do when these contracts go wrong? What are the principal obligations of the parties, what are the grounds of failure and how to prevent it, which rules shall apply and what are the methods of dispute resolution? The article will focus on these and other issues essential to successful drafting and performance of modern commercial contracts in Serbian legal system and particular attention will be given to distribution, franchise and financial leasing as the transactions of special importance for development and further improvement of commercial relations.

Franchise

General overview

The franchise contract, as a relatively new commercial contract is not regulated by law in the Serbian legal system and is thus classified as an unnamed contract (*contrat innommé*). The situation is similar in other national legal systems [list of countries that have regulated franchise by law see in : 20, p.291] since this transaction, established in the USA, was only developed significantly in the mid-twentieth century and was introduced to Europe, primarily, by American companies (McDonald's, Coca-Cola etc). In addition, franchise transaction, due to its mixed legal nature, relates to different legal fields such as contract law, representation and distribution of goods, financial investments, intellectual property, competition law, company law, fiscal law, consumer protection law and liability for damages from products, insurance law, labour law, technology transfer, foreign investment law, etc. For that reason, there are many difficulties in the attempts to regulate it by law [23].

In the Serbian legal system, the franchise contract is subject to the general principles of law, the general rules of the Law on Obligations, as well as to the rules provided by the Law on Obligations for other similar contracts

(licence, sale, lease, commercial representation, etc).¹

In the development of the Civil Code of Serbia, which is underway, the question arose on whether the franchise contract should be regulated by law. In this respect, the expressed views were very much in favour of the regulation of this contract by the national codification, given that the franchisor, in the master agreement, by the choice of law clause, usually imposes his own national law, which could place both the local franchisor and the franchisee into a subordinate position. In addition, it was stated that invoking other similar contracts in resolving a dispute arising from a franchise contract was not a preferred solution, since in this case elements of different contracts would have to be combined. On these grounds, editors of the Civil Code presented a possible Draft of the provisions of the franchise contract (hereinafter: Draft).

Definition and form of the franchise contract

In the legal doctrine there is no uniform definition of the franchise contract. Pursuant to the Draft, the franchise contract is a contract in which one party – the franchisor - grants exclusive rights of sale of goods or provision of services to the other party – the franchisee, authorising the franchisee to act under his registered name (brand), to use his licences (commercial names and trademarks) and other distinguishing marks, to use his technical and commercial methods of conducting business, know-how, marketing, with the provision of expert services and assistance in training and operation of the franchisee, also including the right to constantly provide instructions and monitor the operation of the franchisee, while the other party -

¹ It is generally considered that principal international legal sources for this contract comprise the general terms and conditions of business, type-contracts, legal guidelines and model contracts. At the EU level, the Commission has, within the regulations related to competition, adopted its Ordinance 4087/88 pertaining to a block of exceptions to the categories of franchise agreements of November 30, 1988. A significant role in regulating franchise belongs also to the European Code of Ethics for Franchise, adopted by the European Franchise Federation on September 23 1972, terms and conditions of business transactions by the International Franchise Association (IFA) and the ICC model Contract on Franchise. Within the UNIDROIT, the Legal Guideline for the International Master Franchise Agreements was developed in 1988 and revised in 2007, as well as the Model Law on Disclosure in Franchise in 2002. Franchise rules are also provided by the *Draft Common Frame of Reference*.

the franchisee - pays the adequate fee to the franchisor for the rights granted and services provided (Art. 1257).²

As the franchise contract is not regulated by law in the Serbian legal system, its content is determined by the contracting parties, pursuant to the principle of party autonomy. On the other hand, the Draft provides that a franchise contract must comprise: identification of the contracting parties; the commercial activity in question; exclusive rights transferred by the contract; the amount, deadlines and method of payment of the fee; the territory on which the exclusive rights are used (Art. 1258). According to the Draft, the contractual limitations are to be considered void if they lay down the following: that the franchisor has the right to determine the price at which the franchisee sells the goods, or the price of labour (services) of the franchisee, or determines the lowest or highest price; the franchisee has the right to sell goods or supply services solely to a distinct category of clients, or solely to clients on a specific territory. In addition to the mandatory content of the franchise contract, the Draft, by non-mandatory rules, provides for the contract provisions which may be inserted into the contract (Art. 1265).

Given that it is not regulated by law, the franchise contract may become a formal contract only by the will of the contracting parties. Nevertheless, franchise contracts are generally concluded in writing, primarily due to the need to prove their contents. In addition, this being a long-term and complex contractual relationship which is not regulated by law, the rights and obligations from this relationship should be defined in the contract precisely and in detail, to avoid any potential ambiguous situations that would be a basis for different interpretations and disputes. Finally, an important reason for concluding franchise contracts in writing lies in the fact that they usually comprise the arbitration clause; in most national laws and international conventions, written form is a

prerequisite for the validity of such a clause. The Draft provides for the mandatory written form of the franchise contract (Art. 1259).

In most cases, franchisors conclude standard contracts with their partners from a single franchise system, which are completely prepared in advance as forms and which, in terms of the technique of conclusion, represent contracts of adhesion. Therefore, the franchise contract is, as a rule, concluded as a type contract, prepared in whole by one of the parties. The other party adheres to the pre-defined elements and conditions of the contract, which, as a consequence, leads to the application of general rules of the Law on Obligations, stating that in such a case (Art.100) unclear provisions are to be interpreted in favour of the party that adhered to the contract (the *contra preferentem* rule). On the other hand, contracts of this type usually point to general conditions. In this respect, the Law on Obligations provides a general rule pursuant to which general conditions are mandatory for a contracting party if that party was aware of them at the time the contract was concluded (Art. 142 par.3). In that context, special attention should be paid to the possibility for the Court to abolish certain provisions of the general terms that are “contrary to the objective of the contract itself or good business practices...” or to refuse to apply the provisions that “deprive the other party of the right to object, or cause that party to lose contractual rights or miss deadlines, or are generally unjust or too strict for the other party” (Law on Obligations, Art. 143). When a certain provision of the contract is abolished, the whole contract will not be abolished if it can survive without the abolished provision, i.e. if this provision was neither a prerequisite for this contract, nor the principal motive for its conclusion (about the rules on partial nullity, (Law on Obligations, Art. 105).

Obligations of the franchisor

The main obligation of the franchisor from the franchise contract is to grant, to the franchisee, an exclusive right of sale of products or a group of products or supply of services, as well as the right to use the trademark or service marks and other intellectual property rights pursuant to the terms agreed on in the contract. This obligation encompasses the obligation of the franchisor not to grant this right to other persons on the agreed territory, nor to open branches for the

² Compare with the definition of the franchise contract in the Draft Common Frame of Reference, pursuant to which: “*This Chapter applies to contracts under which one party, the franchisor, grants the other party, the franchisee, in exchange for remuneration, the right to conduct a business (franchise business) within the franchisor’s network for the purposes of supplying certain products on the franchisee’s behalf and in the franchisee’s name, and under which the franchisee has the right and the obligation to use the franchisor’s trade name or trade mark or other intellectual property rights, know-how and business method.*” (Art. 4: 101).

sale of the goods or services on the territory covered by the contract, nor deliver the goods or services under the franchise to other businesses on the given territory. Other forms of intellectual property rights that the franchisor may grant to the franchisee encompass the right to use other distinguishing marks of goods and services, such as symbols, outer packaging, labels of geographic origin, industrial shaping, design of the building, business premises, and interior decoration and equipment. Intellectual property rights must be free from demands or aspirations of third parties. The franchisor is also obliged to transfer certain knowledge and experiences, pertaining, mostly, to know-how. Another group of obligations pertains to the services that are provided in order to make it easier for the franchisee to begin operations and to increase the efficiency of his business, for the activities defined in the franchise contract (assistance in the selection of materials and equipment of business premises, to ensure the uniform appearance conforming to the franchise system, assistance in the selection of adequate premises, staff training, assistance in managing the company, the disclosing of business information and innovations, as well as commercial and technical assistance, etc). Finally, the franchisor must guarantee the franchisee that he will provide an adequate and regular supply. On the other hand, the franchisor reserves the right to control the business operations of the franchisee and the right to be informed on all the issues pertaining to the quality and progress of the franchise. The franchisor also has the right to demand that the franchisee sell only the franchisor's products and the right to influence the price, but in EU countries, he does not have the right to fix the price, whether directly or indirectly, as this would be contrary to Art. 81 (1) of the Contract on Association of the European Community.

In this respect, a special provision in the Draft specifies the basic obligations of the franchisor. Pursuant to the Draft, the franchisor is obliged to allow the franchisee to use his exclusive rights, for the purpose of exclusive sale of goods or services. These rights include: the right to use the brand name, the right to use the trademark or service marks, models and other distinguishing marks, marketing methods and all the other knowledge and experience in the promotion and sale of goods and services. To ensure the realisation of the contracted business activities, the franchisor is obliged to constantly keep the franchisee informed of any facts that enable the successful

conduct of business, to organize training and professional development courses for the franchisee's employees in taking up and managing business transactions, to assist the franchisee in case of dispute in the process of trademark registration and licensing. The franchisor is obliged to supervise the operations, in order to protect the trademark and control its use, as well as to protect the rights transferred to the franchisee in case of any demands put forth by third parties (Art. 1262). The franchisor is responsible for the existence and content of the transferred rights, as well as for the information provided to the franchisee for the realisation of programs included in the transferred rights. In case this responsibility is violated, the franchisee is entitled to terminate the contract or to reduce the fee owed to the franchisor, in the percentage determined by an independent expert (Art. 1263). Finally, the franchisor holds a subsidiary responsibility in third party claims against the franchisee, in case of non-uniformity of characteristics of goods or services sold to third parties by the franchisee, pursuant to the franchise contract. In third party claims towards the franchisee, relating to the products manufactured by the franchisor, the franchisor assumes joint liability with the franchisee (Art. 1266).

The Serbian legal system has no special regulations related to the obligation of advertising under the franchise contract. Nevertheless, franchise contracts concluded in practice regularly comprise a clause regulating this matter. This clause most frequently prescribes that the franchisor is obliged to invest his best efforts in promoting and preserving the reputation of the franchise network. They are, among other things, obliged to design and harmonise the advertising campaigns aimed at promoting the franchise network. Any activities relating to the promotion and protection of reputation of the franchising network are conducted at the expense of the franchisor.³

Obligations of the franchisee

Franchisee's obligations may be classified into those regarding the payment of the fee, and those pertaining to the manner of using the franchise.

The basic obligation of the franchisee is reflected in the payment of a fee for the transferred rights and services. The parties define the type and manner of compensation by

³ See Draft Common Frame of Reference, Art. 4:207.

contract. In practice, it is common to set an initial fee and a fee depending on turnover. In contracts for the franchise of services, as well as contracts between wholesalers and retailers, when it comes to the franchise of goods, it is usually stipulated that the franchisee is obliged to pay a fee depending on turnover (royalty fee). In addition, a single payment at the beginning or upon adhesion (initial fee) is also defined, as well as the minimum amount that the franchisee must pay if the fee is calculated depending on turnover. The fee may be included in the sales price of the product that the franchisor is selling to the franchisee. With regard to the obligation of the franchisee to pay a fee, the Draft provides that the franchisee is obliged to pay a fee for the transferred rights, the amount of which is determined, in general, according to the percentage of realised profit or turnover (Art. 1264).

Concerning the other franchisee's obligations,⁴ the Draft primarily prescribes the obligation of paying a fee for

⁴ The following are, as a rule, the obligations of the franchisee relating to the manner of franchise use:

- 1) to sell exclusively the franchisor's goods defined in the contract on the business premises stipulated in the contract;
- 2) to refrain from performing a similar business activity outside of the territory defined in the contract for the duration of the contract or following contract termination in the agreed period of time;
- 3) to invest his best efforts into the sale of goods or the supply of services that are the subject of the franchise;
- 4) to maintain the building, business premises, equipment and assets pursuant to the contract and the corresponding standards;
- 5) to sell the goods produced exclusively by the franchisor or a third party defined by the franchisor and, in the case this is impractical due to the nature of the goods, to apply objective quality standards;
- 6) to refrain from engaging, directly or indirectly, in similar business activities on any territory which poses competition to the members of the franchise network;
- 7) to sell to end consumers, other franchisors and resellers through other distributive channels only the goods supplied by the franchisor or with his consent;
- 8) to keep, as a business secret, all the information disclosed to them by the franchisor;
- 9) to protect the know-how and preserve the common identity and reputation of the franchise network, selling only the goods that meet the quality standards set by the franchisor;
- 10) to use all the transferred rights only in the business unit defined in the contract, according to the prescribed standards and in the manner specified in the contract;
- 11) to use the know-how solely for the purposes of exploiting the franchise;
- 12) to inform the franchisor of any infringements of industrial or intellectual property rights, and to undertake action against any person committing such infringements or assist the franchisor therein;
- 13) to inform the franchisor of all the experiences gained in his exploitation of the franchise.

In addition to these, the franchisee may take on other obligations prescribed in the contract.

the transferred rights, the amount of which is determined, in general, in accordance with the percentage of the profit gained or turnover. Furthermore, the franchise contract may also impose additional obligations on the franchisee, such as, for example, the procurement of goods from the franchisor or persons named by him, implementation of all the instructions and standards of operation, as well as technological procedures in the production or supply of services, obligation of specific investments, the uniform external appearance of the business seat, etc. (Draft, Art. 1264). In addition, the franchisee is obliged not to disclose to any third parties confidential information or business secrets of the franchisor that were disclosed to him during the term of the contract. This obligation continues to apply even after the termination of the franchise agreement (Draft, Art. 1273).

Supply of equipment, products and services

The obligation of supplying equipment, products and services is not laid down by any special regulations in the Serbian legal system, but rather prescribed under the contract based on the principle of party autonomy. In this respect, it is a widely accepted rule that if the franchisee is obliged to procure products from the franchisor or from a supplier appointed by him, the franchisor undertakes to supply the franchisee with the ordered products in a reasonable time frame. This rule is applied even when the franchisee is not bound by the contract to procure the products from the franchisor or a supplier appointed by them but is, in practice, directed to procure the products in such a way.⁵ In general, the franchisor, as a supplier, is obliged to supply the franchisee in sufficient quantities and regularly; any breach of this obligation is subject to the general rules of the Law on Obligations. On the other hand, the Draft specifies that the franchisor bears subsidiary responsibility in third-person claims against the franchisee in the case of non-uniformity of goods or services sold by the franchisee under the franchise contract. The franchisor shares joint responsibility with the franchisee in third-party claims against the franchisee, with regards to the goods produced by the franchisor (Draft, Art. 1266). If the franchise contract prescribes the procurement of

⁵ See Draft Common Frame of Reference, Art. 4:204.

goods, as a rule, general rules of delivery and payment for these goods are appended to the contract and represent its constituent part which includes explicit provisions on payment guarantees and consequences of delay.

Intellectual property rights, know-how and confidentiality

One of the principal obligations of the franchisor is to transfer the right of use of trademarks or service marks, as well as other intellectual property rights to the franchisee, in line with the contractual conditions. Other forms of intellectual property rights that may be transferred to the franchisee by the franchisor include the right to use other distinct marks, such as symbols, external packaging, marks of geographic origin, industrial design, design of the building, business premises and interior decoration and equipment. The franchisor has to transfer to the franchisee the right to use intellectual property to the extent necessary for the performance of the franchise business. In that respect, the franchisor must grant to the franchisee an unhindered, continuous use of these rights, so long as the aforementioned rights are free from third party claims or aspirations. Within the general provision on franchisor liability, the Draft holds the franchisor responsible for the existence and content of the rights transferred to the franchisee, as well as for the information disclosed to the franchisee necessary for the realization of the programs defined in the rights transferred. In case of an infringement of this obligation, the franchisee is entitled to terminate the contract or to reduce the fee owed to the franchisor to the amount determined by an independent expert (Draft, Art. 1263).

The franchisor is obliged to transfer certain knowledge and experience (know-how) to the franchisee, which the franchisee requires for the conduct of the franchised business activities (Draft Common Frame of Reference, Art. 4:202). This obligation includes not only the technical know-how (secret production methods, the use of recipes, formulae, specifications, procedures and methods of production), but also the so-called commercial know-how, including the knowledge on winning over the consumers, on marketing and turnover, as well as the knowledge on the basic financial management and calculation, including the methods of training commercial associates.

The obligation of the franchisee to protect the information and data on the franchisor and his business as classified information, i.e. as a business secret, is regularly prescribed by franchise contracts (confidentiality clause). A franchisor can impose confidentiality agreements before, during and after the expiration of the agreement. During and after the franchise agreement, parties are free to stipulate these kinds of clauses. However, it should be emphasized that this obligation exists in the Serbian legal system even if it is not explicitly prescribed in the contract, as it derives from the general principles of the Law on Contracts and Torts, primarily the principle of good faith and honesty. The obligation of keeping business secrets is explicitly stipulated in the Draft as well, according to which the franchisee is obliged not to disclose to third parties any confidential information or business secrets of the franchisor, which they obtained during the term of the contract. This obligation continues to be valid following the termination of the franchise contract (Draft, Art. 1273).

Termination of the franchise contract

Termination of the franchise contract due to non-performance is subject to general rules of the Law on Obligations. In addition to the general provisions, the Draft specifies the rules on the termination of franchise contracts due to the expiration of the contractual period, the expiry of the franchisor's exclusive rights, and enforced liquidation or insolvency.

With respect to the termination of contract due to the expiration of the contractual period, the Draft specifies that the duration of the franchise contract is determined by the contracting parties, depending on the needs of distribution of goods or services which are the subject of this contract. If the duration of the contract has not been determined or exceeds ten years, each of the contracting parties has the option of terminating the contract with the obligation of giving a six-months notice, unless the contract prescribes a longer notice period. If an extension of the contract following its expiration has not been prescribed and the contracting parties continue to meet their contractual obligations, the contract is extended, tacitly, each time for a two-year period. Once the contract is terminated due to its expiry, the franchisee is obliged

to return all the leased assets to the franchisor, as well as to stop using the words, elements, marks and all the other brand distinctions that he was granted to use by the franchisor, pursuant to the franchise contract, in the business transactions of his company (Draft, Art.1267).

When it comes to the expiry of the franchisor's exclusive rights, the Draft prescribes that in case the right to use a brand name and other trademarks expires, and they are not replaced by a new brand name or trademark, the franchise contract shall cease to take effect. If there is a change in the brand name and other trademarks of the franchisor, the franchise contract shall produce legal effects with regard to the new brand name or trademarks, if the franchisee does not request termination of the contract and compensation for damage. If the contract is extended, the franchisee may demand a proportional reduction of the compensation paid to the franchisor (Draft, Art.1269).

Finally, pursuant to the Draft, the franchise contract ceases to produce legal effects in the case of enforced liquidation or insolvency of either the franchisor or the franchisee (Draft, Art.1270).

A special rule of the Draft relates to the case of substitution of the holder of exclusive rights. Pursuant to this rule, transfer of any exclusive right, transferred pursuant to the franchise contract to the franchisee, to any other person, does not lead to the modification or termination of the franchise contract (Draft, Art.1271)

Distribution

General overview

In the legal system of Serbia the distribution contract is not regulated by law, so that it falls in the category of unnamed contracts (*contrats innommé*). As an unnamed contract, distribution agreement may be validly concluded in accordance with the principle of party autonomy, within the limits of public policy, mandatory rules and good faith. Due to non-existence of statutory provisions that replace or supplement the will of contracting parties, the distribution contract should be formulated with special attention, so that the intention of the contracting parties be expressed correctly, precisely and unequivocally. In case of dispute, the court shall in principle apply general rules and principles

of law on obligations as well as the rules relevant for other similar contracts (analogy) provided by the Serbian Law on Obligations. In a general sense, one may conclude that the most important national sources of law relating to the distribution agreement include contract as the first source, practices which the parties have established between themselves, trade usage to which parties have agreed, general principles in the field of commercial relations, general principles and rules of the national Code on Obligations as well as its specific rules relevant for the similar contracts, especially the contract of commercial agency and licensing agreement. Having in mind the importance and frequency of distribution transactions in commercial practice, editors of the Serbian Civil Code presented a possible Draft of the provisions of the distribution contract (hereinafter: Draft).

Definition and form of the distribution contract

Distribution agreement, as a typical contract with the origins in the *lex mercatoria*, provides a wide legal framework for housing various forms of distribution transactions that, quite often, involve different legal regimes. However, all forms of that transaction are dominated by specific common characteristics, opening up a possibility of appropriately making its definition. These characteristics are the following: the distribution agreement is a general contract; this contract is an instrument by which a distributor undertakes to periodically buy specified goods from a designated supplier for the purpose of selling them to customers; the distributor purchases the goods on his own behalf, for his account and at his own risk; the distributor sells the goods to buyers at the price and under the conditions determined by himself;⁶ the distributor's profit is expressed by the difference between the selling and the buying price [about general characteristics of the distribution agreement, see more in: 2, p.260; 1, p.100; 8, p.13; 26, pp: 430-473; 14, pp: 359-377]

On that ground, one may conclude that distribution contract is a contract under which one party, the supplier, agrees to supply the other party, the distributor, with products

⁶ See Art. 2 of the Belgian Law, of 27 July 1961, relating to unilateral termination of contract on exclusive distribution entered into for an indefinite period of time, according to which a distribution agreement is any contract by which a manufacturer, who grants distributorship to one or several distributors, grants the right of sale of products (manufactured by the supplier or distributed by him), on his own behalf and for his account.

on a continuing basis and the distributor agrees to purchase them and to supply them to others in the distributor's name and on the distributor's behalf. Within the framework of these general definition various types of distributorship arrangements have been developed in business practices among which the most significant are the following: a) an exclusive distribution contract under which the supplier agrees to supply products to only one distributor within a certain territory or to a certain group of customers; b) a selective distribution contract under which the supplier agrees to supply products, either directly or indirectly, only to distributors selected on the basis of specified criteria and c) an exclusive purchasing contract under which the distributor agrees to purchase products only from the supplier or from a party designated by the supplier. These definitions are widely accepted in comparative law⁷ and reflected in the Draft (Arts.620-621).

There is no formality required to the validity of a distribution contract in Serbian law. A distribution contract concluded orally would be valid according to the principle *solo consensu obligat*, although in practice it is mostly concluded in written in order to provide the prove of its existence and content. Where there is no formality requirements by law, the effects of the form depend of the intention of the parties. If the parties agree upon the written form as a condition of validity of the contract, the contract would produce legal effects only if concluded in the agreed form. It also applies to clauses requiring written form as the condition of validity of possible future amendments. However, one should take into consideration that the court may deny application of clauses of the general terms and conditions precluding the other party to raise exceptions, or of those on the ground of which such party loses its contractual rights or loses time limits, or those which are otherwise unjust or excessively strict towards such party (Law on Obligations, Art.143.2). In addition, such clause would be without effect if it is contrary to the general principle of prohibition of the creation and misuse of a monopoly position (Law on Obligations, Art.14.). In other words, the distributor may not be exposed, by such a clause, to the arbitrariness or *mala fide* acts on the part of the supplier. Taking into consideration that distribution is a long-term and complex contractual relationship for

which there are no supplementary statutory provisions, the rights and duties emanating from that relationship should be precisely and minutely stipulated in the contract, in order to avoid controversies that could be a ground for different interpretation which, as a rule, lead to disputes.

Principal obligations of the parties

The obligations of the contracting parties are defined by contract, in accordance with the principle of party autonomy, and depend on the nature and type of a specific distribution contract to be entered into. However there are certain obligations that regularly appear in contracts of that kind and that, because of this, may be designated as typical.

The basic obligation of the distributor consists in organizing the sale in the interest of the supplier. As a rule, a general clause is included in the agreement by which the distributor undertakes to use best efforts to sell, promote, market and support the products, and to develop and maintain the reputation and goodwill of the supplier and the products in the territory with distributors' consumers [6, p.213] In respect to that obligation of the distributor, the term "best efforts" might become a critical issue due to the possibility of different interpretations, so the parties are well advised to precisely its meaning in the contract.⁸

8 The "best efforts" clause means that the distributor is obliged to perform a specific act by applying due care that stems out of the appropriate standard, but he will not be liable for damage should the act taken fail to realize for supplier the result of the transaction. The Law on Obligations provides that parties in a contractual relationship are bound, in performing their obligations, to proceed with care required in legal transactions in the corresponding kind of such relationships, i.e. the care of reasonable man of business (commercial contracts), and the care of a *bonus pater familias* (civil contracts). This is a general rule, requiring the conduct in conformity with the specific standard. That standard, depending on a particular obligation relationship, presupposes the existence of care of a higher or lower degree, taken as a criterion of liability of debtor who, in performing his obligations, fails to apply due care otherwise required of him. The due care is evaluated in each particular case according to the type of person behaving normally in respect to his capacity, knowledge and profession, the other relevant elements including the expectation in the sphere of business from such person in the corresponding kind of obligation relationships. The Law on Obligations has accepted, as a standard, the objective care, meaning that individual characteristics of contracting parties are not taken as relevant. Since in the concrete case a professional businessman is at issue, i.e. the distributor who performs commercial activities, the criterion would be stricter, so that professional care would be required of him. It goes without saying that this is a *questio facti* which has to be assessed by the court in each particular case, while taking in consideration all relevant circumstances of the case. With respect to this obligation of the distributor, one should underline that, unless otherwise agreed, the distributor has no authority to enter into contracts on behalf of the supplier, or in any way to bind supplier towards third parties.

7 See Draft Common Frame of Reference, art. IV.E.-5:101

The Distributor may advertise the Products and/or his activity as Distributor of the Supplier on Internet, provided he informs the Supplier so that the latter can check that such advertising conforms to his trademark image. The costs of such advertising will be borne, unless otherwise agreed, by the Distributor. Under EC Antitrust Law the distributor must be free to use the internet because the promotion through internet is considered (if not specifically directed to customers outside the territory) as a “passive sale” that cannot be inhibited. Therefore, a general prohibition to advertise on internet would make the distribution contract illegal. The supplier may however verify that the advertising conforms to his image, provided this is not used as an pretext for simply inhibiting to use of internet.⁹ The meaning of the “passive sale” is similarly defined in Serbian law by Regulation on agreements on participants in market trading on different levels of production and distribution (Art.2 point 8).

In addition, the distributor, as a rule, undertakes to establish an appropriate organization of sale, to recruit staff and provide sales premises, in order to effect sale in the entire territory – which is most frequently done in conformity with the supplier’s standards. The distributor may also assume the obligation to establish, within a given time limit, a sales network of a specified number of sales centres. If the distributor possesses his own retail trade network, the contract is concluded and does produce legal effects directly between him and the retailer. Various modalities are possible in the sphere of relationship of the supplier towards this contract – full freedom of the distributor in the choice of subcontractors, the obligation of preliminary notification of the supplier, specific conditions making dependent the choice of subcontractors on the supplier’s consent.

9 IDI International distribution contract – balanced- Art.4, www.idiproject.com. Regulation 2790/1999, art.4; EC Guidelines on Vertical Restraints (§ 51): „If a customer visits the web site of a distributor and contacts the distributor and if such contact leads to a sale, including delivery, then that is considered passive selling. The language used on the website or in the communication plays normally no role in that respect. Insofar as a web site is not specifically targeted at customers primarily inside the territory or customer group exclusively allocated to another distributor, for instance with the use of banners or links in pages of providers specifically available to these exclusively allocated customers, the website is not considered a form of active selling. However, unsolicited e-mails sent to individual customers or specific customer groups are considered active selling.”

The distribution agreement in most case includes stipulation as to minimal quantities of goods to be purchased from the supplier within a specified time period, which is coupled with the supplier’s duty to provide for adequate conditions to ensure such quotas. In principle, should the distributor fail to realize the minimal quota (that may be stipulated in terms of money, quantity of goods or percentage of fulfilling the optimal quota), the supplier may terminate the contract, cancel the exclusivity and/or reduce the contracted territory of the distributor, which depends on the terms of a concrete agreement. On the other hand, the parties frequently include the contract clause providing that supplier must warn the distributor within a reasonable time (or some other period fixed by the parties) when the supplier foresees that the supplier’s capacity will be significantly less than the distributor has reason to expect. Taking into consideration the importance of this obligation in commercial practice as well as its legal consequences, the Draft regulates it in the form of a non-mandatory rule (Art. 629).

Remaining obligations of the distributor in most cases include: respecting the ban on sale outside the agreed territory in exclusive distribution contracts, informing the supplier on all matters relevant for enhancing the sales, confidentiality, possessing minimal warehouse stocks, effecting post-sale services (sale of spare-parts, providing servicing facilities, personnel training, guarantees for proper functioning of products, and the like), exhibiting of products at fairs and expositions, etc . (see Arts.632-641 of the Draft). In exclusive distribution contract and selective distribution contracts, the distributor, as a rule, must provide the supplier with reasonable access to the distributor’s premises to enable the supplier to check that the distributor is complying with the standards agreed upon in the contract and with reasonable instructions given.¹⁰

The principal obligation of the supplier is delivery of the products ordered by the distributor, subject to their availability, and provided payment of the products is adequately warranted. The parties frequently include a contract clause providing that the supplier may not unreasonably reject orders received from the distributor and that a repeated refusal of orders contrary to good faith

10 Common Frame of Reference, art.IV.E-5:305.

(e.g. if made for the purpose of hindering the distributor's activity) shall be considered as a breach of contract by the supplier. Having in mind the legal consequences of rejection of orders by the supplier, the distributor should be obliged to warn the supplier within a reasonable time (or some other period fixed by the parties) when the distributor foresees that the distributor's requirements will be significantly less than the supplier had reason to expect. The same rules are adopted in the Draft (Arts.625 and 629).

Sales of the products to the distributor in most cases are governed by the supplier's general conditions of sale. It is usual that the supplier retains the right to modify prices, provided he gives an appropriate notice to the distributor. In order to avoid abuses, parties may agree that the distributor will be granted the most favoured customer condition. With respect to resale prices of the products, the distributor is usually free to autonomously determine them, with the exception that he is not allowed to sell at prices higher than the maximum resale prices that the supplier may impose. The supplier may indicate recommended resale prices which are not binding and do in no way affect the distributor's right to grant lower prices to his customers. In several jurisdictions antitrust rules forbid suppliers to impose to distributors a fixed resale price. In the EU countries this matter is regulated by EC Regulation 2790/1999, which prohibits clauses or practices requiring the distributor to observe a resale price imposed by the supplier and only allows clauses imposing a maximum sale price or recommending a price on which the distributor is free to grant discounts.¹¹ The similar rule is provided in Serbian law by the Competition Act (Art.10.2.1) and Regulation on agreements on participants in market trading on different levels of production and distribution (Art.5.point 1). For these reasons, the parties to international distribution contract should carefully check whether the contract clause defining the resale prices is in accordance with mandatory provisions of the applicable law.

The other obligations of the supplier usually include: obligation to provide the distributor with information

concerning the characteristics of the products, the prices and terms for the supply, any relevant communication between the supplier and customers, any advertising campaigns relevant to the operation of the business; obligation to provide the distributor with all relevant advertising materials needed for the proper distribution and promotion of the products; obligation to make reasonable efforts not to damage the reputation of the products, etc. (Draft, Arts 625-631).

Termination of the distribution contract

Grounds for termination of distribution contract due to non-performance are in most cases stipulated by the parties themselves (termination clause). General rules of the Serbian Law on Obligations on contract termination (Arts.124-132) will be relevant as supplementary rules in case of implementation of Serbian law as applicable law. One should note in that respect that the Draft adopts a special rule concerning termination due to non-performance providing that the distribution contract may be terminated only in case of fundamental breach of contract (Art.645). Taking into consideration that contract termination is one of the most frequent causes of disputes arising from distribution transactions, parties are well advised to precisely define in the contract all the issues relevant for contract termination - grounds for termination with immediate effect - automatic, *ipso iure* termination, grounds for termination where the other party is obliged to fix to the party in breach an additional period of time for performance (including duration of that additional period of time), notice on termination (means and effects of notice), legal effects of termination, etc.

In addition to termination due to non-performance, the Draft specifies the rules on the termination of distribution contract for a definite period and termination of distribution contract for an indefinite period as well as the rules relevant for the cancellation of contract without giving the cancellation notice in due time (Arts.642-644). The rules are of non-mandatory nature, so the parties may otherwise agree.

One of the most delicate questions in distribution contracts relates to the indemnity in case of termination. Some jurisdictions recognise to distributors a goodwill

¹¹ IDI International distribution contract – balanced- Arts.9 and 10, available at: www.idiproject.com, 23.04.2012.

indemnity at the end of the contract, subject to the existence of certain conditions. If the distributor is domiciled or is doing business in a country having mandatory rules on indemnity, it is recommended to check the situation under the law of such country before formulating the appropriate contract clause.¹² In practices, the parties frequently provide that in case of termination by the supplier for reasons other than a fundamental breach by the distributor, the distributor shall be entitled to an indemnity calculated in accordance with the contract provisions. In principle, the grant of an indemnity does not affect the distributor's right to claim damages for breach of contract committed by the supplier.¹³ Following the best practices, the Draft adopts the rule on indemnity for goodwill, under which, when the distribution contract comes to an end for any reason except for termination due to non-performance, distributor is entitled to an indemnity from the supplier for goodwill if the distributor, on the basis of distribution contract, has significantly increased the supplier's volume of business and if the supplier continues to derive substantial benefits from that business (Art. 646).

Financial leasing

General overview

Financial leasing in the Serbian legal system is regulated by the Law on Financial Leasing of 2003 (hereinafter: Law). By regulating this relatively new transaction, the Law attempts to introduce a high level of legal security in the relations between the contracting parties, without limiting the possibility of their further development of financial leasing transactions, but rather encouraging and stimulating such development. Therefore, the Law establishes a general framework for leasing activities, allowing the contracting parties to regulate their relationships within that framework in accordance with the principle of party autonomy [13; 16, pp: 503-516; 17, pp: 140-152]

The principal legal source used in the Law in defining financial leasing transactions, its basic characteristics and

rights and obligations of parties to these transactions was the UNIDROIT Convention on International Financial

Leasing.¹⁴ A comparative analysis of the Law and the Convention shows that the Law, especially with regard to its basic issues, contains a large number of solutions of the Convention, thus transposing internationally accepted standards into national legislation, in accordance with the entire national legal system, legal tradition and fundamental legal principles. In addition to the UNIDROIT Convention, a significant legal source in drafting this Law were the solutions of the Serbian Law on Obligations pertaining to legal transactions related to financial leasing. Thus, the Law on Obligations regulates rental agreements, agreements on sale with reservation of title – *pactum reservati dominii*, sale with payment in instalments, agreements on loans as well as credit agreements. Finally, in drafting the Law, rules of national laws of other countries regulating financial leasing were also taken into consideration, as well as doctrine views and jurisprudence in comparative law.¹⁵

Definition, content and form of the distribution contract

For the purposes of the Law, a financial leasing transaction is a transaction in which the lessor:

- 1) enters into an agreement with the supplier of the leasing object chosen by the lessee, pursuant to the specifications provided by the lessee and under the terms approved by the lessee so far as they concern his interests, under which the lessor acquires title to the leasing object (supply agreement);
- 2) enters into a financial leasing agreement with the lessee, granting to the lessee the right to possession and use of the leasing object for the agreed period of time in return for the payment of the

14 *Unidroit Convention on International Financial Leasing*. The Convention was adopted in Ottawa on May 28, 1998 and came into force on May 1, 1995

15 The principle of party autonomy as an expression of the centuries-long evolution of contract law and the imperative of compliance with contracts embodied in the principle *pacta sunt servanda* have found its full expression and implementation in the Serbian Law on Financial Leasing. In financial leasing transactions, special importance is given to the principles of the Law on Obligations, in particular to the principle of equality of the parties, principle of good faith and honesty, principle of prohibiting the creation and exploitation of a monopoly position, principle of equivalence of mutual contributions and principle of application of good business practice

12 See IDI International distribution contract – balanced- Art.21, available at: www.idiprject.com, 23.04.2012

13 Ibidem

agreed fee in the agreed instalments by the lessee (financial leasing agreement).

The concept of financial leasing, thus defined, represents a wide legal formula encompassing different forms of this transaction which often include different legal regimes, but which are, nevertheless, dominated by certain common characteristics allowing for the possibility of formulating a definition such as this. These characteristics are reflected primarily in the three-dimensional relationship of financial leasing, with three parties engaged in the transaction: the lessor, the lessee and the supplier, as well as in the rule that the compensation paid by the lessee to the lessor for the use of the leasing object (leasing fee) is established by taking into account primarily the depreciation of the whole or the most important part of the value of the leasing object. These two specific features, in synergy, represent the main characteristics of financial leasing and are, at the same time, the key starting points for distinguishing financial leasing from other related legal transactions.

The Law specifies that the financial leasing agreement must include the following: precise identification of the leasing object, the amount of fee to be paid by the lessee, the amount of individual fee instalments, their number and time of payment, and the duration of the agreement. In addition to these, the financial leasing agreement may include the following: the place, time and manner of delivery of the leasing object, title to the leasing object, the party obligated to insure the leasing object and insured risks, the manner of termination of the agreement, option to purchase or extend the agreement, the transportation costs of the leasing object, its installation, disassembly and maintenance, parts replacement, servicing, technical and technological improvement, training of the lessee's staff to use the leasing object and other terms on which the parties reach an agreement. The leasing agreement must be concluded in written form.

Principal obligations of the parties

The Law specifies the principal rights and obligations for all the parties of the financial leasing transaction – the lessor, the lessee and the supplier. These rules are mostly of non-mandatory nature, so the parties to the particular contract may otherwise agree.

Under the law, the lessor is obliged to acquire the leasing object from the supplier chosen by the lessee, pursuant to the specifications provided by the lessee – *the obligation to acquire the leasing object* (Art.14). In the event of the lessee's bankruptcy, the lessor has the right to exempt the leasing object (exclusion right) from the lessee's bankruptcy estate, in accordance with the law governing bankruptcy proceedings. The lessee and the court competent for conducting bankruptcy proceedings shall notify the lessor, without delay, of the initiation of the bankruptcy proceedings – *protection in the event of lessee's bankruptcy*. The supplier is liable to the lessee for material defects of the leasing object, unless otherwise provided in the agreement – *exclusion of liability for material defects*. The lessor does not incur any liability to the lessee for damage caused by the leasing object except to the extent the lessee has suffered loss as a result of its reliance on the lessor's skill and judgement, or due to the lessor's participation in the selection of the supplier, or specification of the leasing object, unless otherwise provided in the agreement – *exclusion of liability for damage caused by the leasing object*. The lessor is liable for existence of third party's rights on the leasing object which exclude, reduce or limit the lessee's unhindered possession, and of which the lessee was not informed, nor did he agree to accept the leasing object on such conditions – *liability for legal defects*. The lessee notifies the lessor of any third party's claim of rights to the leasing object requests the lessor to free the leasing object of the third party's right or claim within a reasonable time thereafter. The lessee, who initiated and lost a lawsuit against a third party, may invoke the lessor's liability for legal defects, unless the lessor proves that he had available means to reject the third party's claim. The lessee also has the right to invoke the lessor's liability for legal defects of the leasing object even when he, without notifying the lessor and without entering into lawsuit, admitted a third party's right. If the lessee has paid a certain amount of money to the third party to give up its right, the lessor may be released of his liability if he indemnifies the lessee for the amount paid and the loss suffered – *notification of the lessor*. The leasing agreement is terminated if the leasing object is removed from the possession of the lessee and the lessor does not

act according to the indicated lessee's request, unless otherwise stipulated in the agreement. If the lessor does not act according to the indicated lessee's request, where the lessee's unhindered possession is reduced or limited, the lessee has the right to terminate the agreement if the purpose of the agreement cannot be fulfilled accordingly, or has the right to request proportionate reduction of the leasing fee. In both cases, the lessee has the right to claim damages for the loss suffered. The lessee does not have the right to claim damages where the leasing object is taken away from him or his unhindered possession is reduced or limited, if he was aware of such possibility at the time of the conclusion of the leasing agreement – *sanctions for legal defects*. The lessor's liability for legal defects of the leasing object shall not be excluded or limited by the agreement – *limitations or exclusions of the lessor's liability by the agreement*. The lessor may transfer title to the leasing object to a third party. In case of transfer of title to the leasing object, the third party enters the role of the lessor, and the rights and obligations from the leasing agreement are established between him and the lessee accordingly. In this case, the third person cannot request that the lessee delivers the leasing object before the expiry of the agreed period of duration of the leasing agreement. The transfer of title to the leasing object to a third party may be excluded by the agreement or provided otherwise therein – *transfer of title to the leasing object* (Arts. 14-22).

On the other hand, the lessee is obligated to take over the leasing object in the manner, at the time and place specified in the agreement – *taking over of the leasing object*. If the supplier does not deliver to the lessee the leasing object, if he delivers it with delay, or if the leasing object has a material defect, the lessee may, in accordance with the law governing contracts and torts, refuse admission of the delivery or terminate the leasing agreement and is entitled to damage compensation. In this case, the lessor may uphold the agreement if he himself delivers the leasing object to the lessee without delay, under the conditions provided by the leasing agreement. Until the delivery obligation is performed in total conformity with the leasing agreement, the lessee has the right to suspend payment of the fee which he would, under the leasing

agreement be required to pay to the lessor. If he terminates the agreement, the lessee is entitled to refund the fee he paid in accordance with the leasing agreement, minus the amount equal to the benefit derived from the use of the leasing object (reasonable amount) – *termination of agreement due to non-delivery*. The lessee shall use the leasing object with the diligence of a good businessman, i.e. diligence of *bonus pater familias*. The lessee shall use the leasing object in accordance with the leasing agreement or in accordance with the purpose of the leasing object. The lessee is liable for losses suffered by the use of the leasing object contrary to the leasing agreement or contrary to the purpose of the leasing object, regardless of whether the leasing object was used by him or a person authorized by him, or any other person whom he enabled to use the leasing object – *use of the leasing object*. The lessee is obliged to maintain the leasing object in good condition and perform all necessary repairs on the leasing object. The lessee is liable for losses suffered due to the failure to maintain the leasing object in good condition – *maintenance of the leasing object*. The lessee is obliged to pay the lessor the leasing fee in the amounts, at the time and in a manner provided by the leasing agreement – *payment of leasing fee*. The risk of accidental loss or damage of the leasing object shall be borne by the lessee. The risk shall pass to the lessee at the time of taking over the leasing object, unless otherwise provided by the agreement – *risk of accidental loss or damage to the leasing object*. The lessee shall, upon termination of the agreement, return the leasing object intact, with all parts and attachments, to the lessor or the person whom the lessor designates, unless the leasing agreement stipulates that the lessee has the right to purchase the leasing object or to extend the leasing agreement. The lessee is not liable for the wear and tear of the leasing object due to its regular use or for any modifications of the leasing object – *obligation to return the leasing object*. The lessee shall insure the leasing object against risks specified in the leasing agreement, if not otherwise provided in the agreement – *insurance obligation*. The lessee may give the leasing object, in entirety or its parts, to any third party for use, with the written consent of the lessor. The lessor may terminate the agreement and claim damages if the lessee, without

his written consent, gave the leasing object to any third party for use. The special procedure for repossession of the leasing object prescribed by this Law may also apply in case of termination of the agreement. Transfer of the leasing object to be used by any third party shall not relieve the lessee of his obligations to the lessor under the leasing agreement. Transfer of the leasing object for use by a third party may be excluded by the agreement or otherwise stipulated therein – *transfer of the leasing object to third party for use* (Arts. 23-35).

Finally, the supplier is obliged to deliver the leasing object to the lessee in good condition, with any parts and attachments, in the manner, at the time and place specified in the supply agreement, unless the leasing agreement provides that the leasing object is to be delivered by the lessor – *delivery of the leasing object*. If the lessee agreed to the contents of the agreement concluded between the lessor and the supplier, under which the lessor acquired title to the leasing object, subsequent changes to this agreement will not affect the lessee's rights, unless he consented to them – *amendments to the agreement*. If the supplier does not deliver the leasing object to the lessee, if he delivers it with delay, or if the leasing object has a material defect, the lessee has the same rights he would have had under the law governing contracts and torts as party to the agreement with the supplier. Exceptionally to this rule, the lessee is not entitled, without the lessor's consent, to terminate or annul the agreement concluded between the lessor and the supplier, or the right to claim a price reduction. The supplier shall not be responsible both to the lessor and the lessee for the same damage – *supplier's liability to the lessee*. If the supplier was chosen by the lessor, he is jointly with the supplier responsible to the lessee if the leasing object is not delivered to the lessee, if delivered with delay, or if the leasing object has a material defect – *joint liability of the lessor and the supplier* (Arts. 36-39).

Termination of the financial leasing contract

The general rules on termination due to non-performance provided by the Law on Obligations apply to termination of the financial leasing agreement. In addition to general rules of the Law on Obligations, the Law on Financial Leasing

specifies special rules: (i) on termination of the financial leasing agreement by the lessee due to non-delivery of the leasing object, delay in delivery, or material defects in leasing object (Art. 24), (ii) on termination of the financial leasing agreement by the lessor due to non-payment of the leasing rentals (Art. 28), (iii) on termination of the financial leasing agreement by the lessor in the event of unauthorised transfer of the leasing object by the lessee to a third party for its use (Art. 35).

The rules of the Law on contract termination are of non-mandatory nature, meaning that contracting parties, under the principle of party autonomy, may regulate this issue otherwise. The parties may provide different terms for contract termination, whereas these conditions must always be within the limits of public order, mandatory rules and good customs. With regard to termination itself, one should take into consideration the general rule of the Law on Obligations according to which the agreement is terminated automatically (*ipso iure*) when performance of obligation at the agreed time is the essential element of the contract and the debtor fails to perform the obligation at within that time, as well as when the nature of obligation is such that timely performance represents the essential element of the contract (Art. 125). This means that the financial leasing agreement may be terminated automatically, without the obligation of the other party to fix an additional period of time and to inform the lessee of termination, in two cases – where contracting parties have stipulated that the agreement will be terminated if not executed within the agreed deadline or where the circumstances of the case and the nature of the transaction indicate that the performance at the agreed time is the essential element of the contract.

Applicable law and dispute resolution

A crucial issue that arises in all international contracts is that of determining the applicable law. If one consider international franchising, distribution and financial leasing transactions, the differences from country to country are significant. Some legal systems provide special rules protecting one of the parties; other law systems have no statutory rules but the courts have worked out

principles which apply to such contracts; finally, there are national laws which give no special rules concerning these transactions, except the rights granted by the general rules on contracts. Considering this, it is easy to understand why the problem of determining the applicable law is one of the main issues within international franchising, distribution and financial leasing contracts.

Almost all legal systems allow in principle the parties to choose the law to be applied to an international contract. This means that, as a general rule, it is possible to choose a law other than the law that would apply in the absence of a choice of law clause. One should consider some critical issues that could arise in that respect from international distribution and financial leasing transactions.

With regard to distribution contract, one has to distinguish between the framework distribution contract on the one side, and the individual contracts of sale concluded between the supplier and the distributor on the basis of the framework contract on the other side. The framework distribution contract which regulates the long-term relationship between the parties, which is mainly related to the rights and obligations of the parties arising from the distribution relation, by prevailing opinion is not governed by the UN Convention on Contracts for the International Sale of Goods (CISG). Contrary to that, the individual sales contracts which parties conclude each time when the goods suppose to be supplied to the distributor, may fall under the CISG, if the other requirements for application are met. Consequently, the international distribution contract is generally submitted to the different legal regimes.

However, the problem could arise from the fact that the borderline between the framework distribution contract and the sales contracts may be uncertain if the framework contract already contains most of the typical obligations of a seller and a buyer (precisely formulated), so it is only up to the distributor to require delivery at a certain date, in a specified quantity, and just to confirm the seller's obligations which are already provided by the framework contract. It for this reason that some authors does not exclude possibility of application of the CISG rules relevant to the entire framework agreement, if such rules

arise from the general rules of the law of obligations (i.e., if they are not specially adapted to the contract of sale.

In the light of the mentioned problems, one can note that the CISG is created for the needs of international sale. It means that: a. it does not contain the rules adequate for the rights and obligations of the parties arising strictly from the distribution contract (e.g. the distributor's obligation to promote the goods and the seller's brand name or the obligation of the supplier to provide advertising and merchandising); b. regarding the rights and obligations of the supplier and distributor arising from sale, the CISG rules could be inadequate in particular case since they do not take into consideration the specific characteristics of the distribution relation, like for instance the *intuitu personae* nature and the economic objectives to be achieved. On the other hand, the CISG rules which are of "more general nature" like the one related to interpretation of the contract usages, formation of the contract, etc. could perfectly fit the distribution contract.

In sum, one may conclude that problems of applicability of the CISG to the international distribution contract are to be solved on the basis of the facts of each particular transaction and not under a general rule specifying a priori whether it is possible to apply the CISG or not. In case the dispute arises from the rights and obligations of sale, the judge/arbitrator may apply CISG, taking into consideration all relevant circumstances of the case. Contrary to that, if the dispute is related strictly to the distribution contract, the application of the CISG could be inappropriate. Thus, in order to avoid uncertain situations, the parties should, by choice of law clause, precisely solve the question of applicable law to the framework contract as well as to the individual sale contracts.

The other critical issue regarding distribution contract related to the restriction of the the parties' freedom to choose the applicable law provided in some national legislations. As for example, concerning distributors, Belgian law considers the provisions of the law of 27 July 1961 on the «concessionnaires de vente» as rules that cannot be derogated to the disadvantage of the Belgian distributor by submitting the contract to a foreign law. One can therefore conclude that it depends on the law of each country if its rules on distribution contracts have

an «internationally» mandatory, i.e. if they will remain applicable when the contract has been submitted to the law of another country.

As regards the financial leasing, if it is of international character, it is necessary to draw attention to the amendment to Article 10 of the Law on Financial Leasing, according to which the lessor is a company established in accordance with the Law on Companies, which has obtained a license of the National Bank of Serbia to perform financial leasing transactions. In other words, the lessor is considered to be only a Serbian company, which implies that this Law does not apply to cases of international financial leasing, i.e. to such leasing transactions where the lessor is a foreign company. However, in terms of general rules, the contractual relations of international financial leasing are governed by the Serbian Law on Financial Leasing and the Serbian Law on Obligations, if the Serbian law is stipulated as the applicable law by the parties. In absence of the choice of law clause, these laws will be applied if the corresponding rules of international private law lead to Serbian substantive law.

Application of the CISG to financial leasing transaction is doubtful. The main reason is the nature of financial leasing – the financing part of the leasing contract and its regulation of the possession and use of the equipment by the lessee regularly are of greater importance than the sale part of the transaction. In terms of Article 3.2, the CISG does not apply if the preponderant part of the obligations relates to financing and use of the goods available to the lessee. On the other hand, the rules of the CISG in most cases would be inappropriate for the rights and obligations of the parties with respect to the financial part of leasing contract. The second reason lays in the fact that specific rules for financial leasing have been developed on international level, as for instance the 1988 UNIDROIT Convention on International Financial Leasing (Ottawa).¹⁶

However, one should note that financial leasing transaction includes three parties – the lessor, the lessee and the supplier, and two contracts – the supply contract and the leasing contract. In the frame of this transaction, the supply contract between the lessor and the supplier

may be governed by the CISG since it is basically a contract of sale. With regard to the leasing contract, two general rules constitute the main distinction between leasing and sale: 1. the rentals payable under the leasing contract are calculated so as to take into account in particular the amortisation of the whole or a substantial part of the cost of the equipment and 2. when the leasing contract comes to an end the lessee, unless exercising a right to buy the equipment or to hold the equipment on lease for a further period, shall return the equipment to the lessor (the result of the leasing contract is not the final acquisition of the equipment by the lessee unless otherwise agreed by the parties).¹⁷ In the light of these and other specific characteristics of a leasing contract,^[11, pp:20-27] one should conclude that this type of contract generally does not fall into the scope of the CISG. Finally, one may note that, although there is no contract between the lessee and the supplier, the lessee in certain cases may be entitled to claim directly the supplier on the basis of the general rule that duties of the supplier under the supply contract shall also be owed to the lessee as if it were a party to that contract and as if the equipment were to be supplied directly to the lessee.¹⁸ In that case, the problem of the applicability of the CISG may arise as well. Therefore, probably the safest solution would be to expressly stipulate the applicable law both in the leasing contract concluded between the lessor and the lessee and in the supply contract concluded between the lessor and the supplier where the lessee approves the terms so far as they concern its interests.

The other crucial issue of international franchise, distribution and financial leasing contracts is that of choosing the best solution for the resolution of disputes. The main question to be answered is the choice between arbitration and ordinary jurisdiction, i.e. the jurisdiction of national courts. In that respect, one should take into consideration a number of arguments in favour of arbitration.

One of the main advantages of the arbitration is that it provides an independent, impartial and neutral tribunal; if arbitration is chosen, the dispute will be

¹⁷ See Articles 1.2.c and 9.2 of the 1988 UNIDROIT Convention on International Financial Leasing.

¹⁸ See Article 10 of the 1988 UNIDROIT Convention on International Financial Leasing.

¹⁶ There are also more and more domestic rules regulating financial leasing.

decided by arbitrators appointed by the parties – usually two arbitrators of the respective countries and a chairman of a third country or a sole arbitrator of a third country. Contrary to that, in case of the ordinary jurisdiction, disputes will be decided by state courts having jurisdiction on the matter. Other arguments in favour of arbitration lay in the fact that arbitrators are highly qualified experts in the field of international commercial law and that arbitration proceeding is confidential, less formal and more efficient than the state courts proceedings [15, pp: 9-41]. However, if the parties decide to choose arbitration as the means for solving their disputes, they should also take into consideration the costs of arbitration - arbitration is not the best solution in cases of small economic value where the costs of arbitration may be out of proportion. In such situations the parties are well advised to opt for special types of simplified, fast track arbitration which is normally less expensive.

Conclusion

The complex legal nature and structure of franchising, distribution and financial leasing as well as the fact that in most of the legal systems these transactions are not regulated by law, frequently cause disputes and economic loss in commercial practice. The main critical issues in performance of these contracts arise from ambiguous contract clauses defining the rights and obligations of the parties, contract termination and its legal effects, applicable law and jurisdiction. In the Serbian legal system, after adoption of the Law on Financial Leasing and preparation of the Draft Civil Code of Serbia which includes the rules on franchising and distribution, the legal framework of these transactions is much better shaped than is used to be. The statutory rules of non-mandatory nature do not only help the parties in finding the best solutions for their contracts but they also contribute to a better understanding of the principles which are more or less common to the various types of modern commercial contracts. However, the parties shall be aware that, despite the efforts to achieve the appropriate regulation of modern contracts, the courts may express discrepancies in interpretation of the statutory rules. Therefore, the parties are well advised

to precisely define a number of the broad concepts, such as »best efforts« or »reasonable time«. The appropriate contract drafting may avoid most of the uncertainties and provide a successful contract performance.

References

1. Bradgate R., White F., (2004) *Commercial Law*, Oxford University Press
2. Christou R., (1998) *Drafting Commercial Agreements*, London, Sweet/Maxwell
3. *Draft Common Frame of Reference*, Book IV, Part E, Chapter 4: Franchise contracts, 2009
4. Draškić M., (1983), *Ugovor o franšizingu*, Belgrade
5. Draškić M., (1990), *Međunarodno privredno ugovorno pravo*, Belgrade
6. Fontaine M., De Ly F., (2003), *Droit des contrats internationaux*, Bruylant
7. IDI International distribution contract, available at: www.idiproject.com,
8. Kelly P., et al, (1992), *Schmitthoff's Agency and Distribution Agreements*, Kenyon-Slade & Thornton, London
9. *Model Franchise Disclosure Law*, UNIDROIT International Institute for the Unification of Private law, Rome 2002
10. Parivodić M., (2003) *Pravo međunarodnog franšizinga*, Belgrade
11. Perović J., (2004) *Fundamental Breach of Contract of International Sale of Goods*, Belgrade
12. Perović J., (2011) "Selected Critical Issues Regarding the Sphere of Application of the CISG", *Annals of the Faculty of Law in Belgrade, Belgrade Law Review*, Journal of Legal and Social Sciences University of Belgrade, Year LIX.2011.No.3, 181-196
13. Perović J., (2003), *Komentar Zakona o finansijskom lizingu*, Belgrade
14. Perović J., (2010) „Sporne odredbe ugovora o međunarodnoj distribuciji“, *Pravo i privreda*, br.4-6/2010, Belgrade, 359-377
15. Perović J., (2002), *Ugovor o međunarodnoj trgovinskoj arbitraži*, Belgrade
16. Perović J., (2003), "Financial Leasing in Serbia: an Overview of Recent Legislation", *Uniform Law Review*, UNIDROIT, 2005-3, Rome, 503-516
17. Perović J., (2004), *Finansijski lizing kao faktor podsticanja investicija (Financial Leasing as an Investment Stimulating Factor), Oživljavanje privrede i završetak tranzicije (Revival of the Economy and Completion of Transition)*, Kopaonik business forum 2004, Belgrade, 140-152
18. Perović J., (2006) "Odgovornost za nedostatke na predmetu finansijskog lizinga", *Pravo i privreda*, br. 5-8/2006, Belgrade, 2006, 445-458
19. *Prednacr – Građanski zakonik Republike Srbije*, Druga knjiga, *Obligacioni odnosi*, (2009), Vlada Republike Srbije, Komisija za izradu Građanskog zakonika, Belgrade
20. *Rad na izradi Građanskog zakonika Republike Srbije*, (2007), Vlada Republike Srbije, Komisija za izradu Građanskog zakonika, Belgrade

21. Regulation 2790/1999, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:1999:336:0021:0025:en:PDF>,
22. UNIDROIT *Convention on International Financial Leasing*, Ottawa, 1998
23. UNIDROIT, Annex 3 au Guide sur les Accords Internationaux de Franchise Principale, www.unidroit.org.
24. Vasiljević M., (2006), *Trgovinsko pravo*, Belgrade
25. Vukadinović R., (2009), *Međunarodno poslovno pravo*, Kragujevac
26. Willes J., (2005), *International Business Law Environments and Transactions*, McGraw-Hill International Edition
27. Zakon o finansijskom lizingu („Službeni Glasnik Republike Srbije”, 27. 05. 2003. br.55)
28. Zakon o obligacionim odnosima („Sl. list SFRJ”, br. 29/78, 39/85, 45/89 i 57/89 i „Sl. list SRJ”, br. 31/93)
29. Zakon o zaštiti konkurencije („Službeni glasnik RS”, broj 51/09 od 14/07/2009. god.)

Jelena Perovic

Professor at Faculty of Economics, University of Belgrade. Lecturing: International Commercial Law (bachelor classes), International Business Contracts (master classes), EU Private Law (master classes). Professor Perovic is President of the Commission for the International Sale of Goods of International Association of Lawyers (UIA), Paris. Member of International Academy of Comparative Law, Paris. As an expert of the ITC Committee on International Commercial Model Contracts of UN/WTO/ITC in Geneva, professor Perovic is the author of the ITC Model-contract for the International Commercial Sale of Goods. She is scientific collaborator for the *Revue de droit international et de droit comparé*, Bruylant, Brussels. Professor Perovic is specialized in international business law, particularly international sales and related transactions. She has also acted for many years as arbitrator in international arbitration proceedings. Professor Perovic is vice president of the Jurists' Association of Serbia.