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INDIAN FRANCHISE AGREEMENT AND LEGAL ISSUES

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Abstract

A Business man always wants a expansion of his business for the profits, and to provide his goods/services/products to its customers or to make new customers too. Due to limitation of funds and movability he finds himself incapable to do that as they wants, if he allow another person to do that task than he is not able to earn his enterprise to meet out these difficulty, the answer us franchisee mechanism. Franchisee system allow the other parties / person on different location to do the same Business which is developed by someone else and that person eligible to earn the outcomes of his enterprise while he is not Physically involved in that process. Due to this facility and due to support of legal system, it became the best choice of Business world. In this paper researcher tries the depict the relevant process of law required for the well functioning of this system .

Key words :- *Franchise, Franchisee Agreement, Law of Contract, Company Law, LL.P. Business Module, Global Business, Trade name, Trademark, Competition law, Consumer Protection MRTP etc.*

Now a days we are living in a boundary less or Beyond the boundaries world where we have a web Based world, which enabled us to connect any where it makes us eligible to talk or do business round the globe as per our wishes and choices.

Where we are thinking about the availability of commodities of all destination at our door steps. Whether you are in big Metropolitan city or smaller town, one look around you is bound to reveal bright signage with recognizable names all around. From heading to the nearest Kentucky's Fried Chicken (KFC) for a bite to shopping for a particular international Brand of Clothes. The Indian masses have helped the franchising industry rise substantially in the country in recent years.¹ Due to this development and globalization our neighborhood market becomes the world plate form or global market.

In past decades Globalization and market liberalization has fuelled brand awareness among the Indian masses making the importation of foreign Brands (Commodity provides) to Indian stores an attractive business opportunity for local businessmen. It also bound to think, Many Foreign companies or Business entities to consider franchising to convenient mode of entry into any geographically vast and culturally diverse markets, which offers a very favorable franchising environment. India is one of the most potential place for Commercial investment & for Establishing the Franchises too for Business expansion for the world of Business.

The Indian Legal framework has not defined the term Franchise. However, its meaning can be inferred from the Finance Act of 1999, which provides that a 'Franchise' is an agreement that authorises the 'franchise' to sell on manufacture goods, provide services or pursue business identified with the Franchisor.

A Franchise agreement involves a franchisor and a franchisee. While the former refers to an entity which lends its Business or marketable ability or trademark, trade name or any other form of Intellectual Property Rights along with the business system, the latter refers to a person who undertakes the former's business under the mark or name or Franchisor by paying a royalty and an initial fee. Actually its not limited to use the logo or Trade Mark or Trade Name only, using of Trade Secret recipe or method of manufacture, any food or substance to which also be needed an IP Protection or we may say that IP exploitation its an commercial exploitation in any form.

¹ <https://www.ibef.org/blogs/India-franchise-industry-the-road-so-far-and-way-forward>, visited on 20-01-2021 at 12:01AM

India is an attractive destination for a franchising entrepreneurs. The continued growth of the Economy and the Central governments continuous efforts to liberalise the foreign investment policy and improve ease of doing business has led to foreign investors considering India as an attractive investment destination. The Indian franchising market has been growing steadily, to the tune of 30 to 35 percent annually.²

Franchise Business:-

A Franchise is basically a type of license given to a third party by the original owners of the inventor, manufacturer or IP right holder or Business enterprise. The license lets the buyer or franchise use the business name, logo, and products, etc to conduct business under the existing brand name and business model. This has been a successful type of business expansion used all over the world. In India, there are many international and local brands currently operating successfully on the franchise business model. Some famous names include Subway, McDonald's, Kidzee, Khadims and Lakme Salon³ and many more.

An Overview of Indian Franchise Industry:-

One major advantage that players in the franchise industry have is that business model and products/services are already marked the presence with proven marketability or utility in the Business world or markets. It becomes much easier to run a readymade operation, and at times, even support for training and planning of finances are provided by owners to new franchisees. This is just one of the reasons due to which this mechanism made their remarkable presence not only in Indian Market but also in world market too.

The model of franchise management began in the 1990 in India, with the start of the era of liberalization. This system was initially adopted by a few educational institutions and IT Companies for Business expansion and was slow to grow at first. But today the franchise Industry in the country has several well known brands in various cities operating under this model. In a Press conference held at Shastri Bhawan on June 25, 2013 newly sworn in HRD Minister outlined a heavy agenda for primordial reform of India's school and higher education

² <http://thelawreviews.co.uk/edition/the-franchise-law-review-edition-7/1214163/India> visited on 19-01-2021 at 11:52 PM

³ <https://www.ibef.org/blogs/India-s-franchise-industry-the-road-so-far-and-way-forward> visited on 20-01-2021 at 12:11 AM

systems. Remarkable he introduce, he talks about to enact a law to regulate entry and operation of foreign education providers in Indian territory.

Franchise Industry in India:-

The testify or quality accredited business model that franchisor offers is a major reason why the industry is growing in leaps and bounds all over. However, there are several more reasons behind it due to which it achieve a huge success and among the fastest growing Business module in India:-

- Lower rate of failure
- Demand for Franchised Business
- India is big market
- Privatization in different sectors
- Indianization of products and services
- First time – entrepreneurs ⁴

Essentials of a Franchise Agreement:-

A Legal document between the franchisors and franchisee which defines the role and responsibilities of both the parties is known as Franchise agreement. It is necessary to go through Franchise Disclosure Document (FDD) before signing the franchise agreement. FDD precisely mentions even the minute details of agreement. It narrates what one can expect from the settlement, mentions franchisors and franchisee's name, the sort of franchise that being purchased, information in relation to part execution of the franchisor with the project, the region, promotional strategies and the kind of help that a franchisor with the project, the region, promotional strategies and the kind of help that a franchisee may need to grow the business. Franchise agreement is legal proof of broad deal between two parties. It contains information like franchisee's commitments, litigations underlying expenses, income claims. Gain a good knowledge the financial status of business to clearly understand this document.

Element of a Franchise Agreement :-

- An outline of the Relationship
- Location & Territory

⁴ <https://www.ibef.org/blogs/India-s-franchise-Industry-the-road-so-far-and-way-forward> visited on 20-01-2021 at 12:33 AM

- Duration of the Agreement
- Use of Intellectual Property
- Advertising
- Insurance
- Training⁵

The different forms of business entities in India that may be relevant to a franchisor are:

- Sole proprietorship;
- A partner under the Partnership Act 1932;
- A limited liability partnership under the Limited Liability Partnership (LLP) Act 2008; and
- A company incorporated under the Companies Act 2013.

A Sole proprietorship also referred to as a sole trader or proprietorship is an unincorporated business that has just one owner who pays personal income tax on profits earned from the business. A sole proprietorship is the easiest type of business to establish or take apart, due to a lack of government regulation.

A Partnership business may be started by any two or more persons: individuals, partners of firms or even a company, if allowed. Under the partnership, the partners are severally and jointly bound by unlimited liability for the debts and liabilities of the firm and for all actions taken within the scope of partnership.

A limited liability partnership is a body corporate under the LLP Act 2008, where the liability of the limited liability partnership is met by the property of the limited liability partnership and the partners are not personally liable, directly or indirectly, for any obligation arising by the virtue of being a partner in the limited liability partnership.

The Fourth and most convenient kind of legal entity is a company under the Companies Act, 2013. The liability of the members of a company is limited to the assets of the company up to the capital contribution by the members, even if the liabilities of the company far exceed its assets.

⁵ <https://corpbiz.io/franchise-agreement> visited on 20.01.2021 at 11:29PM

It should be noted that for a foreign franchisor to grant a franchise in India it need not establish an entity in India. The franchise can be granted by entering into a franchisee agreement under the aegis of an existing set of laws related to franchise business. However, if the foreign franchisor intends to set up an entity in India, the most convenient form of business entity would be a company incorporated under the Companies Act 1956/2013 and under the foreign direct investment policy of India. As per the rules and regulations of the Foreign Exchange Management Act 1999 (FEMA), a person resident outside India can invest in an Indian proprietary, partnership or LLP subject to prior permission form the Reserve Bank of India (RBI).

The FEMA and RBI regulate the terms of Payment under Franchise Agreement (such as franchise fees, management fees, development fees, administration fees, royalty fees and technical fees) where one party is a Non-Indian entity including the amount to be paid and procedure for remittance of these payments outside India. The RBI prescribes certain requirements such as furnishing of tax clearances and CA certificate at the time of remittance of royalty payments by the franchises to franchisor outside India.

The Indian government permits foreign franchisors to charge royalties up to 1% of domestic sales and 2% on exports for use of the foreign franchisors brand name or trade mark, without transfer of technology. The laws in Indian also permit lump sum and royalty payments to be made by Indian franchises to their foreign counter parts for use of foreign technology which includes manuals, systems etc. lump sum payments upto US \$ 2 million are permitted and royalties of 5% on domestic sales and 8% on exports can be paid to the foreign franchisor.

The government has specified formula for calculation of Royalties which must be adhered to before the foreign company can remit funds out of India. If the franchise agreement proposes royalties or lump sum fees beyond the specified limits, the approval of the foreign investment promotion Board is required.⁶

⁶ <http://www.Setharrocates.com/franchising-law-in-india.html> visited at 12.05 pm on 10-04-2021

Foreign direct investment (FDI) in India is governed by the FDI Policy announced by the government of India and by the provisions of the Foreign Exchange Management Act (FEMA) 1999. FDI is freely permitted in almost all sectors. Under the Foreign Direct Investments (FDI) Scheme, non-residents can invest in the shares, convertible debentures or preference shares of an Indian Company through two routes: the Automatic Route and the Government Route.

Under the Automatic Route, the foreign investor or the Indian company does not require any approval of the investment from the Reserve Bank or government of India. Under the Government Route, prior approval from the government of India, the Ministry of Finance and the Foreign Investors Promotion Board (FIPB) is required.

Investors under the Automatic Route are required to notify the relevant regional office of the RBI within 30 days of receipt of inward remittances, and to file required documents with that office within 30 days of the issue of shares to foreign investors. FDI in activities not covered under the Automatic Route requires prior government approval.

Foreign investment in any form is prohibited in a company, a partnership firm, a proprietary concern or any entity, whether incorporated or not (such as a trust), which is engaged or proposes to engage in the following activities.

- A chit fund;
- A nidhi company;
- Agricultural or Plantation activities;
- Real estate business or construction of farmhouses, except the development of townships and the construction of residential or commercial premises, roads, bridges, educational institutions, recreational facilities and/or city and regional level infrastructure; or
- Trading in transferable development rights (TDRs)

A nidhi company is a kind of non-banking finance company formed with the exclusive object of cultivating the habit of thrift and savings, It functions for the mutual benefit of members.

Investment in the form of FDI is also prohibited in certain Sectors, such as:

- Retail trading (except single brand product retailing);
- Atomic energy;
- Lottery business;
- Gambling and betting;
- A chit fund;
- A nidhi company;
- Trading in transferable development rights;
- Activities or Sectors not opened to private sector investment;
- Manufacturing of cigars, cheroots, cigarillos, cigarettes, tobacco or tobacco substitutes; and
- Agriculture (excluding floriculture, horticulture, development of seeds, animal husbandry, pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro-sectors and allied Sectors) and plantations (other than tea plantations).

Regulatory Framework :-

The important labour and employment laws that might be applicable to franchisors are:

- The Apprentices Act 1961;
- The Child Labour Act 1986;
- The Contract Labour (Regulation and Abolition) Act 1970;
- The Employees Provident Funds and Miscellaneous Provisions Act 1952;
- The Employers Liability Act 1938;
- The Employees State Insurance Act 1948;
- The Equal Remuneration Act 1976;
- The Factories Act 1948;
- The Industrial Disputes Act 1947;
- The Minimum Wages Act 1948;
- The Maternity Benefit Act 1946;
- The Payment of Bonus Act 1965;
- The Workmen's Compensation Act 1923;
- The Payment of Gratuity Act 1972;

- The Payment of Wages Act 1936;
- The Relevant State Shops and Establishment Act; and
- The Trade Unions Act 1926.

In general in India, but also subject to the agreement between the parties, the franchisor and the franchisee do not share a principal agent relationship in the conduct of the business. However, whether the franchisor is or is not resident in India, it is always preferable and advisable to incorporate substantive provisions in the franchise agreement delineating responsibilities, including responsibilities with respect to employees, ensuring that the franchisee's employees are not deemed to be employees of the franchisor.

Franchise agreements in India aren't governed by any Franchise-specific legislation but by various applicable statutory enactments of the country. A few of them includes the Indian Contract Act 1872; the Consumer Protection Act 2019; The Trade Mark Act, 1999; The Copy Right Act, 1957; The Patents Act, 1970; The Design Act, 2000; The Specific Relief Act, 1963; The Foreign Exchange Management Act, 1999; The Transfer of Property Act, 1882; The Indian Stamp Act, 1899; The Income Tax Act, 1961; The Arbitration and Conciliation Act, 1996; and The Information Technology Act, 2000.⁷

Legal Aspects :-

Compared to other parts of the world, the franchise sector in India is at a nascent stage and the general feeling at the moment is that there is no need for Franchise specific legislation. As a consequence, franchising in India is governed by a number of a Statutes, Rules and Regulations, some of which are discussed below.

The Contract Act :-

The Contractual relationship between the franchisor and the franchisee is governed by the ICA, 1872. There is no specific requirement under Indian Law as regards a particular language; however, English is customarily accepted as the standard language.

⁷ <https://www.indiafilings.com/learn/franchising-law-in-india/> visited on 19-01-2021 at 11:24PM

Under the contract Act, “a contract” is an agreement enforceable by law. A Franchise agreement would be enforceable under Indian law since it would meet the criteria of a valid agreement.

However, care needs to be taken to ensure that the agreement does not contain any provisions that render the contract void & voidable. This contract includes a number of provisions that help both parties in understanding their obligations to avoid disputes. The Basic structure or format of the contract popularly known as franchise agreement varies from organization to organization. This format depends on the kind of products or services provided by the company.

Restraint of Trade :-

Section 27 of the Contract Act deserves specific mention. As per said section, agreements in Restraint trade are void. The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). Also regulates agreements that relate to restrictive Trade Practices; however, in the contract of the Contract Act, it is imperative to understand the implications of a Restrictive Provision in a franchise agreement.

While deciding on the issue of restraint of trade in the landmark case of Gujarat Bottling Company Limited v. Coca Cola Company (AIR 1995) (Supreme Court 237) the Supreme Court held that:-

“ There is a growing trend to regulate distribution of goods and services through franchise agreement providing for grant of franchisee by the franchisor or certain terms and conditions to franchisee. Such agreement is often in corporate a condition that the franchise shall not deal with competing goods. Such a condition restricting the right of the franchisee to deal with competing goods is for facilitating the distribution of the goods of the franchisor and it cannot be regarded as a restraint of Trade.”

The International Franchise Association (IFA):-

Defines Franchising as a “continuing relationship in which the franchisor provides licensed privilege to do business, plus assistance in organizing, training merchandising and management in return for a consideration from the franchisee.”⁸

Indian Competition Law:-

In India laws to prevent monopolistic, restrictive and unfair trade practices that distort, free competition in the market are formed in Part A of MRTP Act 1969. Also, the remedies available to the individual consumers for loss and injury suffered as a result of Defective and Sub-standard goods and deception are found in the Consumer Protection Act, 1986 and part B of MRTP Act, 1969. The first part of MRTP ACT, 1969 is mainly directly against the franchisors, whereas Consumer Protection Act and Part B of MRTP act are directed mainly at those masters Franchisees and Franchisees who produce the goods which the Indian Consumer Purchases.

Labour Laws in India:-

India has numerous labour laws which any Foreign or domestic franchisor must be well aware of before doing business, and to mention a few:-

Apprentices Act 1961, Contract Labour (Regulations & Abolition) Act, 1970, Employees Provident Funds and Miscellaneous Provisions Act, 1952, Employees State Insurance Act, 1948 Equal Remuneration Act, 1976, Factories Act, 1948, Industrial Dispute, Act, 1947, Minimum Wages Act, 1948, Payment of Bonus Act, 1965, Workmen's compensation Act, 1923, Payment of Gratuity Act, 1972, Payment of Wages Act, 1936, Parties involved : In a typical franchise agreement, there are minimum two parties involved.

- 1 . The Franchisor who lends his trade name and the Business System.
- 2 . The Franchisee who pays an agreed royalty fees for doing the business under the name of franchisor.

⁸ www.inter-lawyer.com/lex-e-scripta/articles/franchisingindia.htm. visited on 06/01/2019 at 5:23 PM

International Franchising :-

Following are essentially some of the ways in which a franchisee system may be expanded overseas:

- . The Franchisor, either from its headquarters or from a foreign branch operation, grants individual franchises to franchisees in the Target Country.
- . The Franchisor enters into master franchisee agreement
- . The Franchisor establish a subsidiary in the target country, and that subsidiary acts as the franchisor.
- . A Joint venture is established between the franchisor and third party who is knowledgeable about the target country. The Joint venture will act as the Franchisor in the Target Country.

In the Contract of Internationalizing a business, it is important to bear in mind that intellectual property rights are essentially territorial, that is, the rights are limited to the territories in which they have been registered / granted or arisen. Therefore, if a business is planning to take a franchisee operation overseas, it would be important to ensure that its intellectual property rights are protected in the territory.

Franchising Legal Framework in India⁹ :-

Indian Contract Act, 1872

Foreign Exchange Management Act, 1999

T.P. Act, 1882

Labour Laws

Intellectual Property Laws

Compensation Act, 2000

Consumer Protection Act, 2019

Taxation Laws

While franchising as an innovative way of expanding a business into new market places has spread all around the world, different countries have different laws which are applicable to franchising.

⁹ <https://india.franchiseasia.com/information/franchisinglawinindia/>. visited on 1.9.19 at 2:26 PM.

. In the USA there are a range of laws governing the franchising industry. These laws govern the franchisor – franchisee relationship requiring all franchisees offering to be registered and franchisors to provide through disclosure documents. Other Countries with a high degree of franchise regulation include Australia, Brazil and Malaysia.

In many other regions of the world there are no specific laws in place governing the franchise industry. In these places more general laws are applicable to the franchise industry such as in the European Union where franchise relationships are governed by Compensation Laws.

License :- Permission a Grant.

Can be Remarkd anytime For mark

Lease :- agreement of employment :- Specific employment for
Property

Agency :- without consideration

Enforceability and Validity of the Franchising agreement:-

Fundamentally, every franchising relationship is a Contractual relationship and therefore, the Indian Contract Act 1872 (Contract Act) would be applicable to all franchising arrangements.

Under the Contract Act, a ‘Contract’ is an agreement enforceable by law. The following elements are required to constitute a contract:

- a – Capacity of Parties
- b – A offer and an proper acceptance
- c – An Lawful Consideration
- d – Lawful object
- e – Free consent

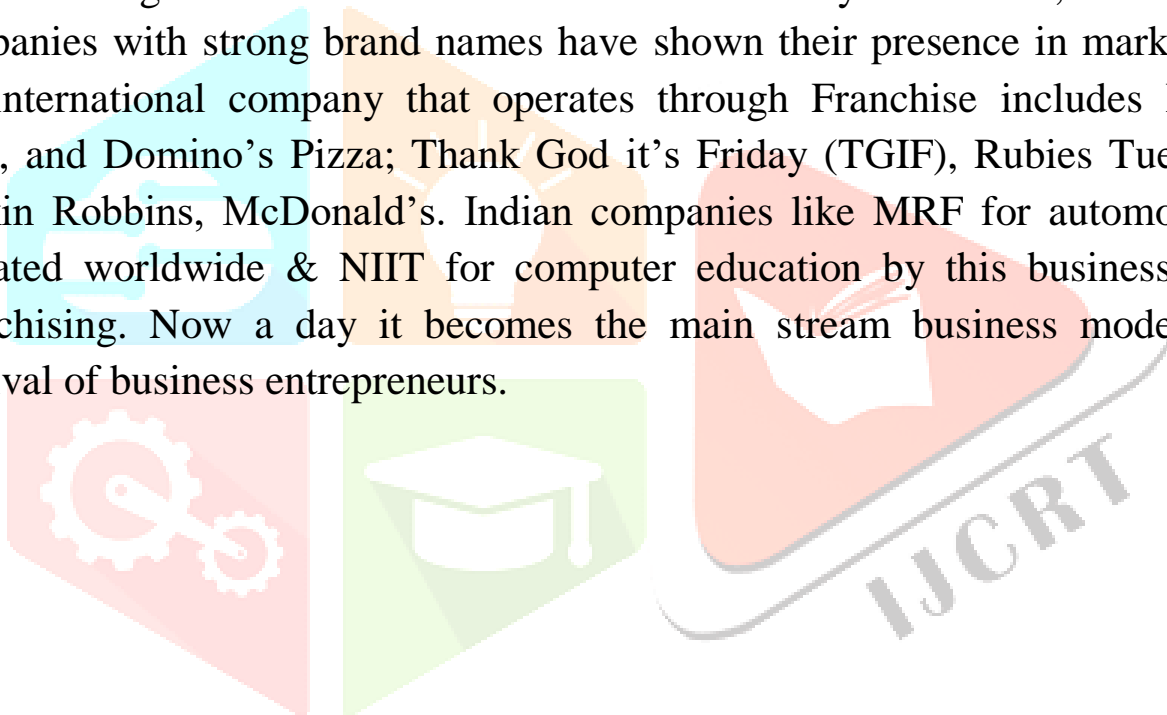
Every franchising agreement would have to necessarily meet the above five criteria in order to be legally enforceable. For example, if the Franchising

agreement is entered into for distributing arms and weapons in India, the same may not be for a lawful object and the hence invalid.¹⁰

Conclusion-

In this study researcher go through the various laws relating to Franchise system in India as well as international law. Through these Municipal /International legal framework it became a convenient business module round the globe. In this regard a firm step was taken in the year 1999 towards consolidation of Franchise industry in India by establishing the Franchising Association of India (FAI) through the efforts of Indo-American chamber of commerce.

Due to globalization & liberalization of economy worldwide, several foreign companies with strong brand names have shown their presence in market places. An international company that operates through Franchise includes Radisson, KFC, and Domino's Pizza; Thank God it's Friday (TGIF), Rubies Tuesday and Baskin Robbins, McDonald's. Indian companies like MRF for automobile tires operated worldwide & NIIT for computer education by this business module, Franchising. Now a day it becomes the main stream business model for the survival of business entrepreneurs.



¹⁰ http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Legal-issues-in-Franchising.pdf visited on 04/02/2021 at 11:02PM