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Legal Aspects of Franchise Business in India

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As our economy is advancing, we are endorsing a rise in different types of business arrangements. India is witnessing the exponential growth of one such business arrangement post-globalization, i.e. franchise business. We are now used to seeing the franchise business successfully settled in almost all sectors and almost in every part of our country. The various business sectors where the franchise business model has created an impact on the growth of the economy and employment include food and beverage, travel and tourism, retail and FMCG products, entertainment, sports, fashion, education, beauty and fashion, health industry etc. The most well-known brands working on this franchise model are Euro Kids, Kidzee, Amul, Baskin-Robins, Starbucks, Medplus, DTDC, Domino's, Tanishq, etc. to name a few. This article intends to evaluate the legal aspects of this franchise business model in India. There is no specific law in force that exclusively deals with this franchise arrangement. Also, the crucial part of this business model is the franchise agreement that is entered between the franchisor and the franchisee. This article also attempts to enumerate the most important clauses that should be present in a franchise agreement to protect the franchisor and franchisee from any future disputes and losses.

Keywords: *franchise business model, franchisor, franchisee, franchise agreement.*

INTRODUCTION

India is a developing country and is on an unprecedented path of development and economic growth. Post globalization India has witnessed exponential growth in business and foreign investments in our country. One of the business models that have flourished over the years is the franchise business model. The franchise business model is seen to be successful in almost all sectors and with all the investors both Indian and Foreign. Have you traveled anywhere in India and not seen McDonalds or Domino's Pizza? You can go to any part of the country and find Amul products or Patanjali Ayurved products. These brands and products have reached throughout the country despite the challenging geographical diversity of the country. This could have been possible because of the Franchise model of business. The Franchise Business model helps to maintain the uniformity of the brand across all the regions. This model has proved itself to be one of the most influential business models. This business model facilitates the expansion of the business of the Franchisor (the brand and product owner) and at the same time allows the Franchisee (the person or entity carrying the business of the Franchisor) to leverage the brand value that is already created and existing. The Franchise model benefits the customer by guaranteeing the same quality of goods and services. The Franchise model has proved itself over a period thereby speeding up economic growth, creating employment opportunities, and enabling rapid business expansion.

FRANCHISE BUSINESS MODEL/FRANCHISE ARRANGEMENT

The Franchise business model/franchise arrangement is not specifically covered under any legislation. The Franchise business model can be defined as permission or rights granted by a well-established entity (Franchisor) to the other person or entity (Franchisee) to carry on the business in its (Franchisor's) name for a valuable consideration.

A Franchise business model is a type of business arrangement entered between the brand owner (Franchisor) and the person/entity willing to leverage the brand (Franchisee). Franchise arrangement does not require franchisees to be registered with any regulatory body in our country.

Types of Franchise Arrangements:

The Franchise can be categorized into three main types:

Format-based Franchise: In such type of franchise, the operational format is to be exactly followed in the development of the product. In this type, the Franchisee has to exactly and strictly adhere to the operational instructions of the Franchisor. Eg. Pantaloons, Wal-Mart.

Product-based Franchise: The Franchisee manufactures the product or delivers the services in such a way that the Franchisee acquires the manufacturing identity of the Franchisor to a great extent. Customers can see the Franchisee himself as the brand owner to some extent. Eg. Domino's Pizza, McDonald's, etc.

Character-based Franchise: In this type, the Franchisee is allowed to manufacture or market the products in the name of a famous personality or even famous fictitious character. Eg. Batman toys, Britney Spears, etc.

Franchise model from Franchisor's and Franchisee's perspective:

The relationship between the parties in this arrangement is that of an Independent Contractor Relationship. This simply means that there is no employer-employee or principal-agent relationship that will come into existence. There would be no vicarious liability that would be arising under this arrangement.

Franchisor's Perspective:

- The Franchisor can earn reasonable to great profits and can grow his business exponentially without actually undertaking the high capital risk.
- The Franchisor can explore and embark upon a larger geographical or territorial expanse which he cannot do individually.
- There is a risk or loss of goodwill for the Franchisor if the Franchisee does not carry the business as per the standards expected.

Franchisee's Perspective:

- Franchisees benefit from the well-known and established branch of the Franchisor.
- Franchisee is also benefited from the experience of the Franchisor and ready-to-use business format.
- Franchisee is supported by the Franchisor for training, advertising, and assistance can be enjoyed in all these respects by the Franchisee.
- There is a chance that the Franchisee may feel controlled by the Franchisor.
- There is a need for substantial capital investment that is to be made by the Franchisee.

LAWS GOVERNING FRANCHISE BUSINESS MODELS IN INDIA

There is no specific legislation present in the country concerning the Franchise Business model. However, the franchise arrangement is a contractual relationship that is established between the Franchisor and the Franchisee and therefore, is being covered under the Contract law of the country. Also, other relevant laws will be attracted as the said business model includes dealing in intellectual property rights, chances of monopolistic acts foreign exchange transactions, consumer satisfaction, etc. Thus, we can enumerate the following legislations that govern the Franchise Business model:

Indian Contract Act 1872: This Act is one of the most important acts, the provisions of which govern all types of contractual relationships. Franchise arrangements can be categorized as Independent Contractor relationships under the Act. The franchise agreement will be governed by the principles of this Act concerning the formation of the contract, performance of the contract, and breach of the contract. The Franchise Agreement should be a valid contract.[1] All the following elements are essential for a Franchise arrangement to be enforceable under the law:

- Valid offer and acceptance (an agreement);[2]

[1] Indian Contract Act 1872, s 2(h)
[2] Indian Contract Act 1872, s 2(e)

- Lawful consideration and lawful object;[3]
- Parties should be competent to contract;[4]
- There should be free consent between the parties i.e. there should be no coercion, undue influence, fraud, misrepresentation, or mistake.[5]
- The agreement should not be expressly declared void under law.[6]

The Competition Act 2002: This Act does not directly make a specific mention of the Franchise but the provisions of this Act restrict all such arrangements that result in the monopoly, thus prohibiting a single franchise that would create any monopoly. The main objective of this act is to promote free trade and prohibit any arrangement that creates anti-competitive business models.

Foreign Exchange Management Act 1999: In any franchise arrangement wherein the Franchisor is from a foreign country, there would be foreign transactions and thus the provisions of this act would become applicable.

Indian Trademark Act 1999:[7] The Franchise arrangement would include the usage of brands and thus the provisions of this act would become applicable.

Other IPR legislations (including patents, designs,etc):[8] If the franchise arrangement is of such nature that it includes usage of patents, designs, copyrights, etc., then the respective laws of Intellectual Property Rights would become applicable.

Consumer Protection Act 2019:[9] The Franchise business is all about providing goods and services to the customers. The interests of the customers are protected by this act and hence the provisions of this legislation would apply to the franchise arrangement.

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[3] Indian Contract Act 1872, s 2(d)
[4] Indian Contract Act 1872, s 11
[5] Indian Contract Act 1872, s 14
[6] Indian Contract Act 1872, s 26
[7] Trade Marks Act 1999
[8] Designs Act 2000
[9] Consumer Protection Act 2019

Companies Act 2013:[10] The Franchisor mostly and the Franchisee at times would be a Company registered under the Companies Act, and therefore the provisions of this act would be applicable.

Any other legislation that may be applicable as per the specific business transaction. There would be other legislations that would govern the franchise arrangement depending upon the franchise arrangement like the Specific Relief Act 1963, various tax legislations, labor laws, dispute resolution laws etc.[11]

IMPORTANCE OF ROBUST FRANCHISE AGREEMENT

The crux of the franchise arrangement lies in the franchise agreement that is entered between the parties. Since the whole reliance of the franchise arrangement is on the franchise agreement; the interests of both the parties are to be secured by doing proper and reasonable negotiations and incorporating it correctly in the agreement. As per the Indian Contract Act, contracts can be entered orally or in writing, but it is advisable to enter into this arrangement by way of the proper written franchise agreement. It is to be noted that the Franchise agreements are not required to be compulsorily registered but it would be advisable to register the same to secure the interests of the parties.

Before entering into a franchise agreement, there are rounds of negotiations that take place between the parties, lots of discussions that happen and ultimately it is decided to go ahead with the transaction. It is at this point that the franchise agreement is executed by the parties. The executed contract shall take into consideration each negotiation that has happened and include all the terms in such a way that it will protect the interests of the franchisor and the franchisee. The well-drafted contract will be a document that parties can rely upon in case of any dispute that may surface in the future.

[10] Companies Act 2013
[11] Specific Relief Act 1963

It has to be understood that the franchisor would be an entity that has well-established itself, whereas the franchisee probably would be new in the business and hence is in a vulnerable position. If the franchise agreement that is entered by the franchisee is not up to the mark and executed just for the sake of recording a transaction and the interests of the franchisee are not properly protected, then such a franchise agreement can bring huge losses to the franchisee when any dispute arises.

Now let us see the most important operative clauses and the negotiations about these clauses of the Franchise Agreement:

Operative clauses are those clauses of the agreement that cover key terms of rights and obligations of the parties. The eleven (11) important and essential [12]operative clauses of the Franchise agreement are:

Scope of Services: This clause includes all the details of the nature of the business, proposed arrangements, geographical scope, and subject matter of the agreement. Negotiation points of discussion would be the term of the franchise, location of the franchise, subject matter of the franchise, etc.

Obligations of Franchisor: This clause enumerates the responsibilities of the franchisor regarding support, development, and monitoring of business. Negotiation points of discussion would be the franchisor's backing to the franchisee, providing training and work guide, evaluation for quality control, and providing required support to the franchisee for the business.

Obligations of Franchisee: This clause enumerates the responsibilities of the franchisee concerning the use of information, Intellectual Property Rights, etc. solely for the operation of the business. Negotiation points of discussion would be the Franchisee to carry the business as per the franchisor's requirements and business model, the franchisee to use the IPR and confidential information only for the operation and use of franchise business, maintain high

[12] 'Exercise on Franchise Agreement' (*Studocu*) <https://www.studocu.com/in/document/university-of-jammu/law-graduation/exercise-on-franchise-agreement/58392349> accessed 10 September 2023

standards of business, etc.

Fees, Charges and Payment: This clause specifies the model of royalties/license fees and any other continuing fee, compulsory fee, and mode of payment. Negotiation points of discussion would be a discussion of the type of payment model that would be adopted, any specific fixed initial deposit to be paid by the Franchisee, duration of payment, mode of raising invoices, payment cycles, etc.

Property: This clause specifies the location of the property acquired for the franchisee business, the mode of acquisition of the property, and its related covenants. Negotiation points of discussion would be the type of rights the franchisee has in the property to be used for the franchise business, the location of the business place to be decided between the parties, and due diligence of the rights of the franchisee's rights in the property.

Confidentiality and Intellectual Property: This clause is crucial to protect the intellectual property rights and confidential information that is shared by the franchisor with the franchisee in the course of business. Negotiation points of discussion would be non-disclosure of confidential information, discussion as to the ownership of new IP created, if any, in the course of business, licensing of IP to the franchisee etc.

Liability: The inherent possibilities of situations arising in Franchise model business like defaults, infringements, negligence, and liabilities arising thereof, are covered in this clause. One of the most important parts of negotiations would include deciding the liabilities that may be incurred by the parties due to the other party's default, negligence, etc., necessary indemnifications to be provided by each party etc.

Term and Termination: This clause will mention the terms of the agreement and the grounds/events that will result in the termination of the agreement. This clause will also include important components of termination i.e. pre-termination obligation, termination, and post-termination obligation. Points of negotiation would be deciding the term of the Franchise, whether it would be renewed, defining the events when parties would be eligible for termination, the cure period to be given, if any, pre and post-termination obligations, etc.

Acknowledgments/Representation & Warranties: This clause enumerates the Representation and Warranties of both parties. Points of negotiation are the parties can conduct due diligence on representations made by each party, and what warranties would be provided by each party to be discussed.

Breach: This clause talks about remedies available to the aggrieved party in the event of failure to perform contractual obligations by the defaulting party. Negotiation points are defining the events when parties would be eligible for termination, the cure period to be given if any, pre and post-termination obligations etc.

Non-Compete Clause – if the transaction demands. This clause will mention the restrictions on the franchisee not to carry out similar business for a particular period after the termination of the agreement and restrictions on the Franchisor not to appoint other franchisees within a particular area of business as decided between the parties. Negotiation points here would include the restrictions on the franchisee to not carry out similar business for a particular period after the termination of the agreement and restrictions on the franchisor to not appoint another franchisee within the particular area of business as decided between the parties.

This clause is not violative of restraint of trade as per the Indian Contract Act.[13] In one of the landmark judgments[14], the Hon'ble Supreme Court has held that negative covenants in the agreement restraining the franchisee for not carrying out any business of a similar brand or competitor of the franchisor are not violative of section 27. Such reasonable restrictions are allowed to be imposed to protect the interests of the parties. This list of clauses enumerated above is illustrative and every franchise agreement would contain clauses as per the requirement of the transaction.

CONCLUSION

We have seen exponential growth in the economy and generation of employment due to the ever-growing franchise business model in India. We don't have any specific law governing the

[13] Indian Contract Act 1872, s 27

[14] *M/s Gujarat Bottling Co. Ltd. & Ors v Coca Cola Co & Ors* (1995) SCC 5 545

franchise arrangement but we rely heavily on the Indian Contract Act, of 1872, and the abovementioned other legislations. The franchise business requires huge capital investment by the franchisee and there is only the franchise agreement that is available to protect the interests of the franchisee. The franchisor is in a better negotiating position than the franchisee and therefore there are chances that the franchisee may suffer if the negotiations and the franchise agreement are not a foolproof one. Hence, the franchise agreement must cover all the above-mentioned operative clauses as well as the other relevant clauses that have to be decided on a case-to-case basis. The full-proof and robust franchise agreement will help both parties to benefit from the franchise business.