

## **FRANCHISING IN INDIA**

### **Introduction**

Although in a nascent stage, franchising is gaining popularity in the retail segment in India, more particularly in the areas of food products and drinks, restaurant chains, consumer goods, and computer training centres. Franchising is one way in which a company can take advantage of India's vast market with a degree of control that other traditional forms of distribution cannot match.

### **What is franchising?**

In a nutshell, franchising is a business system whereunder the franchisor grants a licence to the franchisee to use the franchisor's diverse intellectual property rights, namely, know-how, designs, brands, trade marks, patents, and trade secrets along with the franchisor's proven name, reputation and marketing techniques to market the franchisor's products or services in return for a sum of money. The franchisor provides training and continuous assistance to the franchisee.

### **Difference between franchising/ distributorship/ agency**

The terms franchise, distribution and agency are often loosely used. Distribution and agency are the more traditional forms of distributing goods or services. However, they do not allow the principal to exert any real control over the distributor or the agent. The key distinguishing feature of a franchise is the higher degree of control that a franchisor exercises over a franchisee. The franchisor has a say in all important issues such as branding, methodology and mergers. Although corporate entities such as subsidiaries or joint ventures allow as much if not more control than a franchise, they entail a much higher financial risk.

### **Legal framework**

There is no legislation in India specifically related to franchising. As the relationship between a franchisor and a franchisee flows from a contract, in the absence of specific governing legislation, the law of contracts as embodied in the Indian Contract Act, 1872, and other allied Acts is applicable to a franchise

agreement. Other pertinent areas of the law which are applicable to franchise agreements are:

Intellectual Property laws;  
Competition laws;  
Consumer Protection laws; and  
Labour laws.

### *Intellectual Property laws*

A franchisor is the proprietor of intellectual property rights, know-how, etc. Thus, protection of intellectual property rights is of paramount importance to any international or domestic franchisor.

Foreign nationals and/or companies can protect their trade marks in India under the Trade and Merchandise Marks Act, 1958 (“TM Act”) by registering them under the prescribed class. As yet, service marks cannot be registered in India. (S. 8 of the TM Act) Registered owners can assign to third parties the right to use the mark and are not mandated to use the marks personally. (S. 36 of the TM Act) The assignment agreement must be registered at the office of the Trade Marks Registry. By registering a user agreement, the owner prevents the user from getting a right to be the registered proprietor of the mark through use.

Franchisors can protect their manuals containing the entire technique of establishing and running the business, videos relating to the use of the product, etc. under the Copyright Act, 1957. Civil remedies for infringement of copyright include injunction, damages and accounts of profits made by the defendant by violating the copyright. (S. 55 of the Copyright Act) In addition, criminal remedies such as imprisonment for a period between six (6) months and three (3) years is also available.

### *Competition laws*

Every franchise agreement incorporates highly restrictive terms which would bring it within the purview of the Monopolies and Restrictive Trade Practices Act, 1969 (“MRTP Act”) and lay it open to scrutiny by the Director General of Investigation & Registration or the MRTP Commission.

Restrictive trade practice, as defined, means “a trade practice which has or may have the effect of preventing, distorting or restricting competition.” (S. 2(o) of the MRTP Act) Thus, the first inquiry under the MRTP Act is into the restrictive nature of the trade practice as it relates to the effect on competition. Also, since the main purpose of the MRTP Act is to protect the public, an inquiry into the effect on public interest is always made.

*Per se restrictive trade practices under s. 33(1) MRTP*

Various categories of agreements enumerated under s. 33(1) MRTP, including agreements which restrict persons from whom certain goods can be purchased, have been recognized to be per se restrictive. The consequence of falling within one of these enumerated clauses is that agreements between parties relating to such per se restrictive trade practices must be registered with the Director General (pursuant to s. 35 of the MRTP Act). However, such agreements are not per se void or illegal. The Commission still needs to make an inquiry (pursuant to s. 37 of the MRTP Act) as to whether the agreements are prejudicial to public interest. Until the time that the Commission declares the agreements as prejudicial to public interest, the parties may continue to conduct trade and business under such agreements.

Consequence of registration

The decision to register or not register an agreement lies with the parties to the agreement. However, if an inquiry is made by the Commission who feels that an agreement should have been registered but was not, the burden of proof lies with the parties to prove that the agreement does not fall within one of the enumerated clauses of s. 33(1) of the MRTP Act.

Again, simply by registering an agreement with the Director General does not result in conceding that the agreement is one relating to restrictive trade practices. Rather, the Commission is still required to inquire (pursuant to s. 37 of the MRTP Act) if the agreement is prejudicial to public interest. After an inquiry, if the Commission finds that the agreement is prejudicial to the public’s interest, only then does the agreement become void.

### Consequence of non-registration

If a party to an agreement, which is liable for registration under s. 35 read with s. 33(1) of the MRTP Act, does not register, each member of that party is penalised for the default (pursuant to s. 48(1) MRTP).

One example of a restrictive covenant commonly incorporated in a franchise agreement is a covenant not to compete. The franchisee is prevented from undertaking a business similar to the franchise business during the term of the franchise and for a certain number of years after termination. In fact, the franchisee may even be required not to solicit customers of the franchise business after termination of the franchise agreement.

In a recent development, the Director General of Investigation and Registration has filed an application under the MRTP Act against an Indian company and its foreign joint venture partner on the grounds that the non-compete clause in the agreement amounts to a per se restrictive trade practice. (*Source: The Economic Times, Mumbai, 27 September 1999*)

In this regard, reference should be made to the Indian Supreme Court's decision in M/s. Gujarat Bottling Co. Ltd. v. Coca Cola Company, AIR 1995 S.C. 2372, where the court observed that, "[t]here is a growing trend to regulate distribution of goods and services through franchise agreements and providing for grant of franchise by the franchisor on certain terms and conditions to the franchisee. Such agreements often incorporate a condition that the franchisee shall not deal with competing goods. Such a condition restricting the right of franchisee to deal with competing goods is for facilitating the distribution of goods of the franchisor and it cannot be regarded as in restraint of trade." [sic.] [Emphasis added]

However, the foregoing judgment does not analyse franchising agreements vis-à-vis s. 33(1) of the MRTP Act. Therefore, it is unclear whether it will carry any weightage in the matter pending adjudication before the MRTP Commission.

### *Consumer Protection laws*

The Consumer Protection Act, 1986, substantially impacts the development of franchising in India. It comes into play with regard to tort and other actions arising from sale of defective goods. The issue is if a defective product sold by a

franchisee causes injury to a consumer or causes damage to the consumer's property, then does the consumer have recourse to the franchisor and the franchisee or both! The answer to this depends upon factors such as the degree of control exercised by the franchisor, the distance between the franchisor and the franchisee geographically, and the equipment and know-how supplied to the franchisee by the franchisor in relation to the product.

### *Labour laws*

No franchising contract can derogate from the myriad Indian labour laws. Labour laws governing the day-to-day conditions of employment and termination of employment when an outlet is shut down or the business is sold are particularly relevant in the franchising context.

### **Conclusion**

Considering the growing importance of franchising, the Indian Government should consider enacting a specific statute to curtail the application of the MRTP Act to franchising agreements.