

Franchise

in 32 jurisdictions worldwide

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India

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Overview

1 What forms of business entities are relevant to the typical franchisor?

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

- sole proprietorship;
- a partnership 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 1956.

A sole proprietorship is a business owned by an individual where the owner would have personal unlimited liability for all debts and legal obligations incurred in the course of business.

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 the 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 1956. 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.

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 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 from the Reserve Bank of India (RBI).

2 What laws and agencies govern the formation of business entities?

The formation of a sole proprietorship for the purpose of franchise business is not governed by any specific law. However, the sole proprietor would be required to obtain a permanent account number (PAN) and value added tax (VAT) or service tax registration, if applicable.

The establishment of a franchise business through a partnership firm shall be governed by the Partnership Act 1932.

Formation of a LLP is governed by the LLP Act 2008 and requires the association of two or more persons to carry on the lawful business. It must be registered with the registrar of the state in which the registered office of the limited liability partnership is situated. This also requires obtaining the PAN or VAT or service tax registration.

Setting up a company in India is subject to the Companies Act 1956. The company must be registered with the registrar of companies (ROC). In the case of any foreign investment, subject to the allowed limits of foreign direct investment in that sector, the other rules and regulations under FEMA will have to be complied with.

3 Provide an overview of the requirements for forming and maintaining a business entity.

There is no specific provision or regulation for establishing a sole proprietorship.

In the case of a partnership business, a minimum of two persons are required to form a partnership. The sharing of profit or loss by each of the partners and the dissolution of the firm solely depends on the terms and conditions of the partnership deed. The partners of the firm act as agents of the firm and also of other partners; therefore their unlimited liability is several and joint, and extends even to their personal assets. Though it is not compulsory to register the partnership firm, on registration the firm obtains the right to sue and be sued in its own name.

The limited liability partnership is a separate entity and also requires the association of a minimum of two persons for carrying on the lawful business of the LLP firm. The LLP must be compulsorily registered with the registrar of the state in which the registered office of the LLP is situated. An LLP's liability is to be met by the property of the limited liability partnership and is not the personal liability of a partner. The personal liability of the partner cannot be shunned in the case of his own wrongful act or omission, but the partner is not liable in the case of such a wrongful act or omission being committed by any other partner.

If a company is to be incorporated under the Companies Act 1956, the memorandum and articles of association (MOA and AOA, respectively) of the company must be filed with the ROC. The MOA is the constitution of the company and outlines the following:

- the name of the company;
- the state of the registered office of the company;
- the objects of the company and the activities ancillary to the objects of the company;
- that the liability of the members is limited in case the company is limited by shares or guarantee; and
- the authorised share capital of the company.

The AOA contain internal rules and regulations for the running of the company's management and its other internal affairs. When the forms have been completely filed with the ROC, a certificate of incorporation is issued by the relevant ROC. A company must

hold a shareholders' annual general meeting every year within six months of the end of the financial year, and at least one board meeting every three months. Further, a company is required to file its annual returns, tax returns and audited financial statements with the relevant government authorities every year.

4 What restrictions apply to foreign business entities and foreign investment?

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 Investment 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 businesses;
- 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).

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

If resident in India, the franchisor's income from royalty or franchise fees would be treated as business income in India and shall be subject to income tax. However, if the franchisor is not resident in India and

franchises its business from outside India, any form of taxation in India shall also be subject to the existence of any tax treaty between India and the franchisor's country of operation.

6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

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 1961;
- 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.

7 How are trademarks and know-how protected?

In India there is a well-established framework protecting intellectual property rights (IPR) related to trademarks, copyright, inventions, technology, designs, etc. Depending on the business activities of the franchisor, the following IP laws would be relevant in protecting its intellectual property:

- the Trademarks Act 1999;
- the Copyright Act 1957;
- the Designs Act 2000; and
- the Patents Act 1970.

In order to protect the franchisor's trademarks, it is advisable to have them registered under the Trademarks Act 1999. Trademark rights are territorial in nature; the registration of a trademark in any other country will not provide any statutory protection to the franchisor in India, hence a suit for infringement cannot be filed in a court of law. However, it may be possible to undertake an action for passing off, which is a common-law right, although this protection is not as strong as the protection given to trademarks registered in India. Infringement of trademarks registered in India in the name of the franchisor, and infringement in cases of passing off, gives the legal right to the franchisor to file a suit for injunctive relief, supplemented by a criminal complaint against the offender. The franchisor can also claim damages or potential lost profits and order the destruction of the products infringing labels and trademarks.

Once registered, a trademark is valid for a period of 10 years with the provision of renewal before expiration and from time to

time thereafter. If the trademark is not renewed before the expiry period of 10 years, it will be removed from the Trademarks Registry's records.

A franchisor's know-how and confidential information such as trade secrets, designs and copyright are likewise also protected as trademarks by virtue of the relevant set of laws existing in India. The above-described procedure and set of laws are effective enough to protect the intellectual property rights of the franchisor and the franchisee as well.

In addition to the above, the protection of a franchisor's trademarks and know-how can be made more effective by including adequate clauses pertaining to their protection in the franchise agreement, and by including an express obligation on the franchisee to respect the trademarks and know-how.

8 What are the relevant aspects of the real estate market and real estate law?

As per the existing laws in India, a non-resident cannot buy or sell a property in India. A non-resident franchisor will have to incorporate a company in India; thereafter, the Indian company can buy the real estate. There are no restrictions on a domestic franchisor acquiring property within India, but the franchisor will be subject to compliance with local laws, which vary from place to place. However, as a common practice, the responsibility of owning a property for a franchising business under the franchise agreement belongs to the franchisee and not the franchisor.

The relevant real estate laws are:

- the Transfer of Property Act 1882, which regulates the sale, mortgage, lease and gifts of immoveable property;
- the Indian Easement Act 1882, which deals with licensing of immoveable property;
- the Registration Act 1908, which regulates the registration of agreements and documents;
- the Indian Stamp Act 1899 and relevant State legislation, which deals with the levy of stamp duty;
- rent control legislation, which regulates tenancies and letting of immoveable property; and
- other relevant development rules and regulations, and the relevant provisions of FEMA where the property is being acquired by a non-resident person.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

There is no specific legislation in India dealing with franchising. However, chapter 5 of the Finance Act 1999 defines a 'franchise' as:

an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with the franchisor, whether or not a trademark, service mark, trade name or logo or any such symbol, as the case may be, is involved.

10 Which laws and government agencies regulate the offer and sale of franchises?

India does not have any specific legislation regulating franchising businesses. Franchising in India is basically built on the principles of contract law – namely the Contract Act 1872 – while the Foreign Exchange Management Act 1999 regulates all franchising activities involving foreign investments and foreign remittances. The various statutes that may be relevant include:

- the Indian Contract Act 1872;
- the Copyright Act 1957;
- the Trademark Act 1999;
- the Patent Act 1970;

- the Geographical Indication of Goods (Registration & Protection) Act 1999;
- the Semiconductor Integrated Circuits Layout Design Act 2000;
- the Monopolies and Restrictive Trade Practices Act 1969 (the MRTP Act);
- the Competition Act 2002;
- the Specific Relief Act 1963;
- the Consumer Protection Act 1986;
- the Sale of Goods Act 1930;
- the Income Tax Act 1961;
- activity-specific legislation, which includes:
 - the Prevention of Food Adulteration Act 1954;
 - the Drug & Cosmetic Act 1940; and
 - the Pharmacy Act 1948;
- the real estate laws, which include:
 - the Transfer of Property Act 1882;
 - the Indian Easement Act 1882;
 - the Registration Act 1908;
 - the Indian Stamp Act 1899;
 - state legislation; and
- employment and welfare legislation, which includes:
 - 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 1961;
 - the Payment of Bonus Act 1965;
 - the Workmen's Compensation Act 1923;
 - the Payment of Gratuity Act 1972;
 - the Payment of Wages Act 1936; and
 - the Trade Unions Act 1926.

11 Describe the relevant requirements of these laws and agencies.

The relevant requirements of these laws in a franchise agreement are based on the tenets of India's contract law, which covers various concepts such as offer, acceptance, validity, breach and termination and governs the rights and obligations of the parties. But there are other issues that a franchisor may need to look into in order to protect various rights and interests. Other legislation may also be applicable, such as:

- the Specific Relief Act 1963, which concerns remedies such as injunctions and damages in cases of breach;
- the Trademarks Act 1999, the Patents Act 1970, the Designs Act 2000, and the Copyright Act 1957, all of which protect the franchisor's intellectual property rights;
- the MRTP Act and the Competition Act 2002, which regulate competition in the business sector;
- the Consumer Protection Act 1986, which gives redressal rights to consumers and ensures that the products or services supplied by the franchisor and franchisee are of the highest standard;
- the Income Tax Act 1961, which governs the tax aspects of any franchising business in India;
- the FEMA, which governs the principles of India's foreign investment policy and also contains the rules and regulations for the payment of royalty and franchise fees to the franchisor by the franchisee; and
- various labour laws that protect the interests of employees.

12 What are the exemptions and exclusions from any franchise laws and regulations?

As there are no specific laws for franchise businesses, there are no specific exemptions and exclusions.

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

As there are no specific laws for franchising businesses in India, there are no particular requirements or regulations that a franchisor must meet before it may offer a franchise.

14 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no specific requirement to make pre-sale disclosures to sub-franchisees.

15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

There is no requirement for making pre-contractual disclosures.

16 What information must the disclosure document contain?

In the absence of any specific legislation for franchising and any disclosure requirements, the Common Law Doctrine of Law of Equity would prevail. In this scenario, the disclosure document must comply with the doctrine and must be genuine so that both parties are on an equal footing before they enter into any agreement.

17 Is there any obligation for continuing disclosure?

No specific statutory obligation for continuing disclosure is applicable to current franchisees.

18 How do the relevant government agencies enforce the disclosure requirements?

Since disclosure is not a necessity under any statutory legislation, it will only be a requirement under the Common Law Doctrine of Law of Equity.

India is a common-law country; therefore, in the case of any dispute following the franchising agreement's execution, the Indian courts are likely to insist that such pre-contractual disclosures have taken place prior to the execution of the agreement. In such a scenario, the liability of the parties would depend on the nature of the dispute.

19 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Disclosure is not a statutory requirement, but the franchisee is able to file a civil suit for damages in the case of misrepresentation or breach of warranties under the franchise agreement, or even a criminal complaint for criminal breach of trust. Generally, damages in such cases would be actual rather than consequential.

Entitlement to reimbursement or damages after the franchisee has cancelled or rescinded the contract would depend on the terms and conditions of the survival clauses of the franchisee agreement.

20 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

In cases of sub-franchising, the sharing of liability between the franchisor and the sub-franchisor for any disclosure violations would be totally governed by the contractual agreement between them. If the franchisor and sub-franchisor have a principal-agent relationship, then the franchisor would be vicariously liable for any acts or omissions made either in the course of business or in good faith by the sub-franchisor.

In general, individual officers, directors and employees of the franchisor or the sub-franchisor are not held liable unless any of the violations were specifically undertaken by an individual. However, the personal liability of any officers, directors and employees of the franchisor and the sub-franchisor will certainly be relevant in cases of criminal contempt.

21 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

There are no specific laws existing in India for the offer and sale of franchises. The area is governed by a plethora of laws, depending on the nature of the franchise business. In general, franchising follows the principles of the existing contract law in India (see question 10 for applicable laws).

22 Are there any general obligations for pre-sale disclosure that would cover franchise transactions?

There are no statutory requirements in this regard. It will be governed by the contract between the parties.

23 What other actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

See question 19.

Legal restrictions on the terms of franchise contracts and the relationship between parties involved in a franchise relationship

24 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The relationship between the franchisor and the franchisee after the execution of the contract would be governed to a large extent by the principles of the Indian Contract Act 1872. However, other laws are also applicable (see question 10), depending on the nature of the franchise business.

25 Do other laws affect the franchise relationship?

See question 10.

26 Do other government or trade association policies affect the franchise relationship?

Government or trade association policies do not affect the franchise relationship between the franchisor and the franchisee.

27 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The circumstances in which the franchise relationship may be terminated by a franchisor shall be governed by the franchise agreement.

28 In what circumstances may a franchisee terminate a franchise relationship?

The circumstances in which the franchise relationship may be terminated by a franchisee shall be governed by the franchise agreement.

29 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

A franchisor may refuse to renew the franchise agreement with a franchisee under the terms of the franchise agreement. If there is no particular clause in the franchise agreement regarding renewal or if the terms for renewal of the contract have not been complied with, the franchisor may terminate the franchise agreement.

30 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

The franchisor can validly restrict a franchisee from transferring its franchise or restrict the transfer of ownership rights in a franchisee entity to a different entity. In order to make such restrictions effective, relevant terms and conditions must be expressly provided for in the franchise agreement.

31 Are there laws or regulations affecting the nature, amount or payment of fees?

There are no particular laws with respect to the nature, amount or payment of fees. Payment of franchise fees or royalties shall be governed by the franchise agreement.

32 Are there restrictions on the amount of interest that can be charged on overdue payments?

As per the current existing laws, there are no restrictions on the amount of interest that can be charged on overdue payments. However, such payment would be dependent on a mutual agreement between the parties to the franchise agreement.

33 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

There are no restrictions on making payments to the franchisor in its domestic currency. However, any payment to be made by the franchisee to the franchisor must conform to the existing RBI norms for remittance and other FEMA regulations.

34 Are confidentiality covenants in franchise agreements enforceable?

Yes.

35 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Under common law principles, the parties are under a legal obligation to deal with each other in good faith. In case of any breach of

trust between the parties, the party aggrieved by such conduct has legal remedies both for redressal under criminal breach of trust and for damages in a civil suit.

36 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No existing laws in India treat franchisees as consumers. Franchisors and franchisees enter into a franchise agreement on an equal footing. Franchisees are typically linked to the franchisors with regard to liability to consumers and maintaining the highest standard of products and services under consumer protection laws.

37 Must disclosure documents and franchise agreements be in the language of your country?

There is no requirement in India that disclosure documents or franchise agreements be in any local language. It is common practice for agreements to be executed in English.

38 What restrictions are there on provisions in franchise contracts?

Any franchise contracts in India will have to be within the parameters of the existing applicable laws, which generally allow the parties full freedom to agree on various matters such as duration of the contract, jurisdiction, prices to be charged, dispute resolution, etc. Parties are also free to impose suitable restrictions on each other under the contract in order to protect their own business interests. Such restrictions could be related to confidentiality, non-disclosure, non-compete, non-solicitation, assignment, choice of jurisdiction and dispute resolution methods.

39 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

The MRTP Act regulates and restricts monopolistic and restrictive trade practices. Under this Act, a restrictive trade practice is defined as 'a trade practice which has or may have the effect of preventing, distorting or restricting competition.' The main purpose of the existing competition law in India is to investigate the effect of the actions of businesses on competition and to protect the public and their interests.

The government has also enacted the Competition Act 2002, which is soon to replace the MRTP and will regulate competition in different businesses. The Competition Act provides for the establishment of the Competition Commission of India and, though it is yet to be notified, is aimed at promoting free trade and ending protectionism. The Act's main areas of focus are prohibition of anti-competitive agreements, prohibition of abuse of dominant position and regulation of combinations.

40 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The court system in India starts at the district level. District courts are at the bottom of the ladder and have the original territorial jurisdiction over the whole of a particular district. The high courts of each state are courts of appeal for all issues except constitutional matters. The apex court (Supreme Court) is the highest appellate court of the country.

The dispute resolution methods available to franchisors and franchisees are litigation, arbitration, conciliation or mediation. However, in cases of cross-border franchises, it is always advisable to have an international forum for arbitration. Domestic arbitration can be chosen under the Arbitration and Conciliation Act 1996.

- 41** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

Arbitration law in India is governed by the Arbitration and Conciliation Act 1996. The foundation of an arbitration is both parties' agreement to submit to arbitration all or certain disputes which have arisen or which may arise between them. Thus, a provision for arbitration can be made at the time of entering the contract itself, so that if any dispute arises in future, it can be referred to arbitration as per the agreement. It is also possible to refer a dispute to arbitration after the dispute has arisen. The arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement. It must be in writing and signed by both parties.

One of the principal advantages of arbitration is that it provides much faster redressal of commercial disputes compared to traditional litigation, which is very time-consuming in India. Parties can also choose a venue outside India for arbitration. If a

foreign award is passed, Indian courts come into the picture at the time of implementation. The courts have only limited grounds on which to refuse to implement the award.

A foreign award can only be enforced in India if the award has been passed in a territory which has been notified by India as a reciprocating territory. If the foreign award has been passed in a territory which has not been notified by India as a reciprocating territory, the award cannot be enforced; in such a situation the foreign franchisor will have to initiate fresh legal proceedings in India.

- 42** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Under the 'Rule of Law' in India, foreign franchisors are treated in the same way as domestic franchisors in all respects. There is no scope for any differentiation under law or in practice. The rights and business interests of any foreign franchisor are protected in just the same way as those of domestic franchisors.

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