Newslex: December - January 2016

FRANCHISING IN INDIA

INTRODUCTION

Off late, Franchising has been gaining popularity in major countries of the world. Franchising has become most sought after concept in the contemporary business arena. The application of the economic principles laid down by the concept of franchising has indeed resulted in one of the most successful and systematic way of assuring global presence of the concerned business. Franchising is gaining popularity in the retail segment in India, more particularly in the areas of food products & drinks, restaurant chains, consumer goods, and computer training centres. In country like India where cultural diversities make retailing a big challenge, franchising is allowing the companies to truly think global and act global.

Franchising means granting of certain rights by one Party (the franchisor) to another (the franchisee) in return for a sum of money. There is no specific legislation regulating franchise arrangement in India, reason being the complexity of the relationship and the vast areas of law which such relationship involve. The Indian law does not define franchising. However, the Blacks Law Dictionary defines a franchise as a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark.

WHY THERE IS A NEED OF FRANCHISING IN INDIA

- To provide the commitment and quality of brands to customers.
- To draw more sales and profitability of the brands and for the future success and popularity of the brand.
- To offer a great shopping experience to customer in retail sector and to provide continuous excellence services to customer.
- For demand of exquisite and innovative products.

LAWS GOVERNING FRANCHISING IN INDIA

In the absence of a franchise-specific legislation in India, a franchise arrangement would be governed by various applicable statutory enactments prevailing in India. A gist of some important statutes is summarized as a brief overview.

1) Indian Contract Act, 1872:

Fundamentally, every franchising relationship is a contractual relationship and therefore, the Indian Contract Act, 1872 (“Contract Act”) would be applicable to all franchising arrangements. The Indian Contract Act 1872 governs the contract between the parties to a franchise agreement. This contract

Act provides “All Agreements are contracts, if they are made by the free consent of the parties, competent to contract, for a lawful consideration, with a lawful object, and not hereby expressly to be void.”
Franchise agreements are also covered under the Specific Relief Act 1963, which provide for both specific enforcement of covenant in a contract and remedies in the form of damages for breach of contract.

2) Competition Act, 2002:

The objective of the Competition Act, 2002 is to prevent practices having adverse effect on competition, to promote and sustain competition in market, to protect the interest of the consumers and to ensure freedom of trade carried on by the other participants in the market. The Competition Act, 2002 prohibits arrangements related to production, supply, distribution, storage, acquisition or control of goods or provision of services that cause or are likely to cause an appreciable adverse effect on competition within India. Under the Competition Act, tie-in arrangements, exclusive supply and distribution agreements, and resale price maintenance would be regarded as being anti-competitive if such agreements cause an appreciable adverse effect on competition in India.

3) Consumer Protection Act 1986:

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.

4) Indian Stamp Act, 1899:

In India, every state has its respective Stamp Duty Act with schedule of rates of stamp duties on various instruments. Normally, agreements, contracts, power of attorney, lease or license deed, bill of exchange, awards, bonds, hundies, instruments, receipts, promissory note, shares or such other documents are written on revenue stamps. In India, the law provides that documents must be adequately stamped in accordance with the stamp act as Section 35 of the Indian Stamp Act, 1899 mandates that the instruments not duly stamped are inadmissible in evidence.

5) Registration Act 1908:

The object of registering documents is to give notice to the world that such a document has been executed, to prevent fraud and forgery and to secure a reliable and complete account of all transactions effecting the title of the property. Where a document is employed to effectuate any of the transactions specified in Section 17 of the Registration Act, 1908 such document must be registered.

6) Intellectual Property Rights:

In India, the primary laws governing intellectual property rights are the Trademarks Act, 1999, the Copyright Act, 1957 and the Designs Act, 2000. These legislation deal with the licensing of trade marks, copyright, systems, etc., from a franchisor to a franchisee, for the purpose of operating and conducting the franchised business. Further, under these statutes, civil and criminal remedies are available to a franchisor against infringement of intellectual property rights. For example, in case of infringement of a trade mark, civil remedies would be in the nature of an injunction or stay against the use of the trade mark and damages can also be claimed.
Since, intellectual property license lies at the centre of the franchise, the laws governing licensing or intellectual property constitute that basis of the franchise laws. While licensing Intellectual Property Right both Parties should follow the necessary provisions of law. Similarly, while transmitting trademarks, the franchisor must make sure that the transmission does not create exclusive rights to use the mark in more than one person, with respect to trademark for the same type of goods and services or similar depiction of goods and services and such resemblance should not cause or likely to cause or create any confusion or trickery. The exact nature and extent of the rights granted should be specified in the license.

7) Labour Laws:

Labour law if important to franchises in relation to the various outlets, shops and offices in which persons are employed. No franchising contract can derogate from the myriad Indian labour laws. Labour laws governing the day-to-day conditions of employment and are particularly relevant in the franchising context when an outlet is shut down or the business is sold, in relation to the amount of compensation payable by the Master Franchisee, franchisor or franchisee. India has numerous labour laws which any foreign or domestic franchisor must be well aware of before doing business.

8) Foreign Exchange Management Act, 1999 (FEMA):

The FEMA and Reserve Bank of India regulate the terms of payment under Franchise Agreements (such as franchise fees, management fees, development fees, administrative 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 chartered accountant certificate at the time of remittance of franchise fee payments by the franchisee to franchisor outside India.

9) Taxation Laws:

Taxation is another issue which deserves due consideration. It is important to know the local sales tax, property tax, withholdings tax and other local taxes applicable in certain area. Further, how the franchise arrangement is structured and the existence of treaties between the countries involved may have considerable influence on the structure adopted. Where the franchisor receives royalties, service or franchise fees, tax has to be paid under the Income Tax Act (as income arising and accruing in India), whether the franchisor is an Indian or foreign. In case where the foreign franchisor sends training personnel and supervisors to India, the salaries payable to these persons may be subject to personal income tax, whether an arrangement is made to deduct the tax at source or they are taxed as self-employed persons (professionals). In certain franchise agreements, the franchise is restricted from purchasing the registered product except from franchisor in which there can be excise duty, sales tax and if the products are to be imported from other countries, there may be import duties also.

10) Real Estate Laws:

In India, premises for conduct of the franchised business may be acquired either on ownership basis, or by way of a leave and license or lease arrangement or by way of a business conducting arrangement. The Transfer of Property Act, 1882 and the various state-enacted legislation on renting of immovable properties govern these arrangements.

CHALLENGES FOR FRANCHISEES IN INDIA

There are various problems faced by the Investors for franchising in India. Some of which are political instability, under developed financial system, weak legal system that protects intellectual property rights and upholds contractual obligations, under developed infrastructures, low income of customers, entry barriers, high exit cost, huge investment, lack of transparency in business, a brand famous in one country may not survive in other country, lack of awareness among the customers about the available brands in the market, unavailability of cheap retail space, etc.

THINGS TO LOOK OUT FOR WHILE DRAFTING A FRANCHISE AGREEMENT

The structuring of the franchise system and the drafting of documentation for franchising in India is very crucial, because adopting readymade structures and documentation from other countries may not grant adequate protection to both, a franchisor and a franchisee in India. It is essential that franchise agreement is duly stamped and registered and is drafted and negotiated carefully as it forms the basis of the franchising relationship. Some of the important issues that a franchising agreement needs to address are outlined hereunder:

- Scope and Subject matter
- Licensing and Protection of IPR
- Obligations of the Franchisee
- Obligations of the Franchisee
- Consideration
- Taxation
- Termination and its Consequences
- Notice Provisions
- Negative Covenants
- Indemnification
- Arbitration
- Governing Law
- Jurisdiction

CONCLUSION

Over the years, it appears that franchise has become one of the most attractive model to expand the business presence for both domestic and international players in India. However, given the diversified and exhaustive legal regime governing the said model and the growing popularity of thereof, this may require a definitive and dedicated legislative framework in the times to come.

The Payment of Bonus (Amendment) Act, 2015

Introduction:

The Payment of Bonus (Amendment) Bill, 2015 was introduced in Lok Sabha by the Minister of State for Labour and Employment, Mr. Bandaru Dattatreya, on December 7, 2015. The Bill seeks to amend the Payment of Bonus Act, 1965.

Both houses of the Parliament passed the Payment of Bonus (Amendment) Bill, 2015 on 23rd December 2015.

Further The Payment of Bonus (Amendment) Act, 2015 **(“Act 2015”)** received the assent of the President on the 31st December, 2015 and was notified on the even date.

Background

The Payment of Bonus Act, 1965 (**“Act”**) provides for the annual payment of bonus to employees of certain establishments (including factories and establishments employing 20 or more persons).

Under the Act, bonus is calculated on the basis of the employee's salary and the profits of the establishment. The Act requires the employer to pay to an eligible employee a minimum bonus at the rate of 8.33% of the salary earned by the employee during the accounting year or INR 100 (approx. US$ 1.5), whichever is higher. As per law, the maximum statutory bonus can be limited to 20% of the employee's salary.

Key Amendments passed

- **Employees eligible for bonus:** The Act mandates payment of bonus to employees' whose salary or wage is up to Rs 10,000 per month. The Act 2015 seeks to increase this eligibility limit to Rs 21,000 per month.
- **Calculation of Bonus:** Under the provisions of the Act if an eligible employee's salary is more than INR 3,500 per month, for the purposes of calculation of bonus, the salary will be assumed to be limited to INR 3,500 per month. The Act 2015 raises this wage ceiling to INR 7,000 per month or the minimum wage notified for the employment under the Minimum Wages Act, 1948, whichever is higher.
- **Retrospective Effect:** The Act 2015 shall be made applicable from 1st April 2015.

Analysis

Cabinet has approved the effective date on bill as 1st April 2015, the bill was presented in Lok Sabha with effective date proposed as 1st April 2015, however as per Lok Sabha website, effective date passed by Lok Sabha is 1st April 2014 and the same date is also mentioned in the Gazette Notification.

In our view the date is wrongly published as 1st April 2014. Effective date of the Act 2015 shall be 1st April 2015 and not 1st April 2014. The appropriate authority shall issue a clarification on it.

Further the retrospective effect of the Act 2015 shall cast a huge burden on the employers, as the employers will have to contribute more towards the bonus and with the effect of the Act 2015 large number of workers who would fall within the salary bracket of INR 10,000 - 21,000 per month will trigger the bonus payouts. The appropriate authority has also not considered the fact that books of accounts for the year 2014-15 has already been closed and the employers must have already set aside the bonus payouts in their books of accounts.

Also recently Kerala High Court has passed an interim order dated 27th January, 2016 in the case of '**The United Planters' Association of Southern India and Others vs. the Union of India and Others'**, staying the retrospective applicability of the said Act 2015. Further following the orders of Kerala High Court, Madhya Pradesh Labour Office has issued a circular dated 4th February 2016, staying the retrospective applicability of Act 2015, pending the orders from the appropriate authority.