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The Legal 500 Country Comparative Guides

India

FRANCHISE & LICENSING

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This country-specific Q&A provides an overview of franchise & licensing laws and regulations applicable in India.

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INDIA

FRANCHISE & LICENSING



1. Is there a legal definition of a franchise and, if so, what is it?

There is no legal definition of a franchise under Indian law.

2. Are there any requirements that must be met prior to the offer and/or sale of a franchise? If so, please describe and include any potential consequences for failing to comply.

Registration Requirements

No, there are no pre-sale requirements for sale of a franchise business in India, and a franchisor is not required to register the offering with any Government agency before sale of a franchise.

3. Are there any registration requirements for franchisors and/or franchisees? If so, please describe them and include any potential consequences for failing to comply. Is there an obligation to update existing registrations? If so, please describe.

Disclosure Requirements

No, the franchisor is not required to make any disclosures to franchisees or a Government regulator before sale of a franchise business.

4. Are there any disclosure requirements (franchise specific or in general)? If so, please describe them (i.e. when and how must disclosure be made, is there a prescribed format, must it be in the local language, do they apply to sales to sub-

franchisees) and include any potential consequences for failing to comply. Is there an obligation to update and/or repeat disclosure (for example in the event that the parties enter into an amendment to the franchise agreement or on renewal)?

Other Requirements

No, please refer to the response in Question 3.

5. If the franchisee intends to use a special purpose vehicle (SPV) to operate each franchised outlet, is it sufficient to make disclosure to the SPVs' parent company or must disclosure be made to each individual SPV franchisee?

Under Indian law, a franchisor is not required to make any disclosures to its potential franchisee, including franchisee's SPV.

6. What actions can a franchisee take in the event of mis-selling by the franchisor? Would these still be available if there was a disclaimer in the franchise agreement, disclosure document or sales material?

Under Indian law, agreements that are based on misrepresentation, fraud, and undue influence are voidable at the option of the party subjected to such misrepresentation, fraud, and undue influence. A franchisee may set aside the agreement that is based on mis-selling by the franchisor and make a claim for damages.

A franchise may also file a criminal complaint under the Indian Penal Code, 1860 against the franchisor for "cheating" if the franchisor acts fraudulently or dishonestly with criminal intent.

A disclaimer in an agreement may or may not absolve the franchisor from liability of mis-selling depending on the totality of facts and circumstances of each case.

7. Would it be legal to issue a franchise agreement on a non-negotiable, “take it or leave it” basis?

Although a franchisor can issue a non-negotiable franchise agreement under Indian law, this practice is uncommon. Franchisees often negotiate terms of the franchise agreement.

8. How are trademarks, know-how, trade secrets and copyright protected in your country?

Trademarks are protected under the Trademarks Act 1999. There is no specific law to protect trade secrets and know-how. In absence of a specific law, Indian courts protect trade secrets and know-how based on principles of common law and equity as well as the agreement between the parties relating to protection of confidential information. Courts generally grant injunctions to prevent unauthorised disclosure of trade secrets and know-how; or directs the party acting in breach to return the confidential information to the other party; and/ or awards damages for misuse of trade secrets and know-how.

9. Are there any franchise specific laws governing the ongoing relationship between franchisor and franchisee? If so, please describe them, including any terms that are required to be included within the franchise agreement.

India does not have a franchise-specific law. The franchisor-franchisee relationship is subject to a number of other laws, such as foreign exchange control regulations, anti-trust laws, intellectual property laws, tax regulations, data privacy laws, and anti-corruption legislation.

10. Are there any aspects of competition law that apply to the franchise transaction (i.e. is it permissible to prohibit online sales, insist on exclusive supply or fix retail prices)? If applicable, provide an overview of the relevant competition laws.

The Competition Act, 2002 (“Competition Act”) is the primary anti-trust legislation in India. The Competition Act requires that enterprises or persons at different stages of the production chain should not enter into an agreement for production, supply, distribution, storage, acquisition or control of goods or provision of services if such agreement will cause appreciable adverse effect on competition. Specifically, exclusive supply agreements; exclusive distribution agreements; agreements for refusal to deal; or agreements for resale price maintenance (i.e. agreement for fixing the minimum price for the goods and services) between enterprises or persons at different stages or levels of the production chain will be declared void if they cause appreciable adverse effect on competition.

The restrictions that are commonly imposed on franchisees under a franchise arrangement, including prohibition of online sales, and exclusive supply are not per se anti-competitive if such restrictions are reasonable and are aimed to promote the standard, efficiency and uniformity of a franchise system. However, the Competition Commission of India, pursuant to an allegation that a franchise arrangement is anti-competitive, may examine the reasonableness of the restrictions contained in that franchise agreement and its net effect on competition on a case-by-case basis.

11. Are in-term and post-term non-compete and non-solicitation clauses enforceable?

In-term non-compete restrictions on a franchisee and its owners are generally enforceable. However, the enforcement of post-term non-compete restrictions could be a challenge where such restraint imposes undue restrictions on the freedom of the Indian franchisees and their owners.

Both in-term and post-term restrictions relating to non-disclosure of confidential information, and non-solicitation are generally enforceable in India, provided they are reasonable.

12. Are there any consumer protection laws that are relevant to franchising? Are there any circumstances in which franchisees would be treated as consumers?

Although India has a consumer protection law, namely the Consumer Protection Act, 2019 (CPA), it is unlikely that the CPA would apply in a franchisor-franchisee relationship. It may be difficult to classify a franchisee as a ‘consumer’ under the CPA because a person who

obtains goods or services for resale or for any commercial purpose is generally excluded from the definition of consumer.

13. Is there an obligation (express or implied) to deal in good faith in franchise relationships?

The doctrine of good faith and fair dealing is not expressly incorporated in Indian contract law, except for certain special categories of contracts, such as agency contracts, and insurance contracts. However, many Indian courts have opined that every contract agreement inheres in itself the principle of "Good Faith".

14. Are there any employment or labour law considerations that are relevant to the franchise relationship? Is there a risk that the staff of the franchisee could be deemed to be the employees of the franchisor? What steps can be taken to mitigate this risk?

The franchisee will be solely responsible for its employees under the prevailing employment laws of India. It is unlikely that the franchisor will have any liability towards the employees of the franchisee. However, it is always best to clarify this intent in the franchise agreement.

15. Is there a risk that a franchisee could be deemed to be the commercial agent of the franchisor? What steps can be taken to mitigate this risk?

Generally, franchise arrangements are based on a principal-to-principal relationship. However, if certain rights and powers granted to a franchisee under the franchise agreement are of the nature that are usually exercised by agents, the franchisee may be deemed as a commercial agent of its franchisor. To mitigate the agency risk, a franchisee should not be provided with powers which are generally exercised by an agent, and the franchise agreement should clearly state that the relationship between the parties is based on a principal-to-principal arrangement.

16. Are there any laws and regulations that affect the nature and payment of royalties to a foreign franchisor and/or how much

interest can be charged?

The Foreign Exchange Management Act, 1999 ("FEMA") and regulations framed under the FEMA, regulate cross border transactions dealing with foreign exchange. The FEMA and accompanying regulations are commonly referred to as foreign exchange control regulations. The foreign exchange control regulations are administered and enforced by the Reserve Bank of India (RBI), which is India's central bank.

Foreign exchange control regulations prescribe permissible and prohibited foreign exchange transactions. Under the prevailing foreign exchange control regulations, payments for royalty, franchise fee, management fee, service fee, and other similar fees can be remitted to foreign franchisors without prior permission of the RBI. Before remitting money to foreign franchisors, Indian franchisees will have to comply with applicable tax regulations and follow specific procedures including withholding applicable tax on royalty, franchise, and other fees to be paid. Only after the completion of formalities can the Indian franchisee make an application to its bank to remit payment to the foreign franchisor.

For certain special payments, prior permission of the RBI (or authorized dealer bank) may be required. For example, RBI approval may be required for remittances of money for services that are due beyond the maximum prescribed time; or for setting-off of payments due between parties.

There are restrictions on the maximum amount of interest that can be charged by a foreign party on certain types of overdue payments, such as payment for services received by an Indian franchisee from its foreign franchisor. The maximum permissible rate of interest is fixed by the RBI from time to time. In respect of other types of overdue payments (such as on royalty payments), there are no express restrictions on the maximum amount of interest that can be charged. However, it would be open to the RBI (or authorized dealer bank) to question the validity of such interest payment to ensure that the same is not an artifice to remit money, where such remittance would not ordinarily be permissible under exchange control regulations.

17. Is it possible to impose contractual penalties on franchisees for breaches of restrictive covenants etc.? If so, what requirements must be met in order for such penalties to be enforceable?

Under Indian law, only reasonable damages commensurate with the loss caused to a non-defaulting party can be recovered. It is typically not possible to impose contractual penalties on the franchisees for breach of restrictive and other covenants.

18. What tax considerations are relevant to franchisors and franchisees? Are franchise royalties subject to withholding tax?

The Income-tax Act, 1961 ("IT Act") is the legislation that governs direct taxes. The IT Act requires Indian franchisees to deduct appropriate withholding tax on royalties and other fees to be paid to their foreign franchisors.

India has entered into double taxation avoidance agreements (DTAA) with various countries. The IT Act provides that withholding tax could be deducted at the rate prescribed in the IT Act, or the DTAA (between India and the home country of the foreign franchisor) whichever is more beneficial to the foreign franchisor.

Since the IT Act and DTAA prescribe different withholding tax rates for different categories of services, parties must analyze both the IT Act and the DTAA to determine the actual rate of withholding tax for each type of service.

There is no prohibition on grossing up of taxes. A foreign franchisor may contractually agree with its franchisees to increase the payments to offset the withholding taxes that are to be deducted by the franchisees on royalty, technical fee, advertisement fee, management fee and other similar fees.

19. Does a franchisee have a right to request a renewal on expiration of the initial term? In what circumstances can a franchisor refuse to renew a franchise agreement? If the franchise agreement is not renewed or it if it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the compensation payment calculated?

The renewal of a franchise agreement, including the consequences for the failure to renew the franchise agreement, will be purely governed by the terms thereof.

20. Are there any mandatory termination rights which may override any contractual termination rights? Is there a minimum notice period that the parties must adhere to?

No, termination rights will be purely governed by the franchise agreement. Indian law does not prescribe a minimum notice period that should be adhered to prior to termination of a franchise agreement.

21. Are there any intangible assets in the franchisee's business which the franchisee can claim ownership of on expiry or termination, e.g. customer data, local goodwill, etc.

A franchisee's right in any intangible assets of a franchise business will be subject to the terms of the franchise agreement. Franchisors generally reserve all rights in the goodwill associated with the franchise business.

Customer data in the form of personal and sensitive information of a natural person is owned by that person. Therefore, in respect of personal and sensitive information, it may not be possible for either the franchisor or the franchisee to claim ownership. In respect of ownership in other categories of customer data, the franchise agreement will prevail subject to applicable privacy laws, namely the prevailing Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

22. Is there a national franchising association? Is membership required? If not, is membership commercially advisable? What are the additional obligations of the national franchising association?

Yes, there are non-government franchising associations in India, whose membership is not mandatory. A franchisor or a franchisee may opt to become a member of one or more such organisations after evaluating the proposed benefits from the services to be provided by such associations.

23. Are foreign franchisors treated

differently to domestic franchisors?

No, except for foreign exchange laws which apply for cross border payments

24. Are there any requirements for payments in connection with the franchise agreement to be made in the local currency?

In case of an arrangement between an Indian franchisor and an Indian franchisee, the payments should be made in Indian currency. However, payments can be made in foreign currency to a foreign franchisor, subject to compliance with foreign exchange control regulations.

25. Must the franchise agreement be governed by local law?

No. Parties are free to choose any governing law (as long as one of the parties to the agreement is a foreign entity / individual). However, Indian courts are not typically comfortable exercising jurisdiction in cases calling for the application of foreign law, due to their unfamiliarity with foreign laws.

26. What dispute resolution procedures are available to franchisors and franchisees? Are there any advantages to out of court procedures such as arbitration, in particular if the franchise agreement is subject to a foreign governing law?

Parties to a franchise agreement may opt to resolve disputes in Indian courts. However, on average, it takes about three to seven years in disposal of a suit by the court of original jurisdiction and another one to three years in appeal cases.

To avoid delays, parties may opt to resolve disputes under a franchise agreement through arbitration. The Indian Arbitration & Conciliation Act, 1996 ("Arbitration Act") governs arbitration in India and enforcement of foreign arbitration awards. Indian courts would not typically interfere in matters where the parties have agreed in writing to refer their disputes to arbitration pursuant to an arbitration agreement.

The parties to an international franchise transaction may select a venue for resolution of disputes either in India or outside India. For foreign seated arbitration, the venue should be situated in any country that is a signatory to (i) the Convention on the Recognition and Enforcement

of Foreign Arbitral Awards ("New York Convention"), or (ii) the Geneva Convention on the Execution of Foreign Arbitral Awards ("Geneva Convention"), provided such country is also notified by the Indian Central Government. Currently, the Indian Government has notified fifty countries that are signatories to the New York Convention and the Geneva Convention.

27. Does local law allow class actions by multiple franchisees?

Although local law allows for class action suits subject to certain conditions, class actions suits are not common in India.

28. Must the franchise agreement and disclosure documents be in the local language?

No. English is the business language used throughout India.

29. Is it possible to sign the franchise agreement using an electronic signature (rather than a wet ink signature)?

Execution of a contract in India using an electronic signature that meets the requirements of the Information Technology Act, 2000 ("IT Act") is considered at par with the execution of a contract using wet signatures. That said, a contract signed using electronic signatures that are not recognized under the IT Act will not necessarily render the contract void. In the case of any dispute regarding the existence or modification of a contract made using an electronic signature, the person disputing the existence or modification of the contract will have to prove that the contract was never signed or modified.

30. Can franchise agreements be stored electronically and the paper version be destroyed?

Although Indian law does not expressly require that the paper version of the franchise agreement be signed and retained, it is generally recommended to maintain paper versions of the agreement to avoid enforcement challenges in Indian courts.

31. Please provide a brief overview of

current legal developments in your country that are likely to have an impact on franchising in your country.

Currently, there are no significant legal developments in relation to franchise arrangements.

32. In your opinion, what are the key

lessons to be learned by franchisors as a consequence of the COVID-19 crisis?

The key lesson to be learned as a result of COVID-19 is for the franchisor to have the ability to adapt to local conditions, and have built-in flexibility in the franchise agreement/arrangement to account for force majeure events such as COVID-19.

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