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# **FRANCHISEE AGREEMENT: AN ANALYSES**

AUTHORED BY - DEEP KAPADIA

## **Abstract**

Franchisee concept is growing with leaps and bounds, it is seen out of every 7 businesses 1 turns up into the franchisee systems. A wide analyses shows that the franchisee system is cost effective but gives commanding returns.

Also, the risk involve of investment, dependency on employees, non-attention of employees and is divided as we get the franchisee owner who himself is involved in business as if it is his own, and act with full interest and enthusiasm to grow the business.

Though the Franchisee system is highly preferred but there are yet no laws in India. So, how do we look towards the Franchisee development in India. Very simple answer is Franchisee can be analysed or measured in law on following aspects:

1. Intellectual Protection Act
2. Supplier-Distributor relationship/ service provider relationship
3. Taxation systems
4. Franchisee and Franchisor relation
5. Dispute resolution<sup>1</sup>

But, above it, most important is Franchisee Agreements, and majorly entire India depends on working of franchisee under the roof of „agreement“ i.e. Contract Act, 1856.<sup>2</sup>

This Research paper, probe in the analyses of the agreement formation for the „Franchisee“. Generally, the franchisee agreement or any business agreement goes with following terms:

1. Parties involved in the franchisee
2. Purpose or type of franchisee

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<sup>1</sup> In my last research paper on ‘Arbitration in Franchisee System’, published by IJLRA, p.49 have given details on dispute resolutions.

<sup>2</sup> It is very difficult to understand how the company law is extrapolated in determining the franchisee system

3. Grant of Franchisee- Territorial rights, Terms and renewals and Franchisee IP rights.
4. Franchisee Income: Franchisee fees and Royalty or terms of payments
5. Franchisor obligations- Training support, advertising and branding support and other facilities
6. Franchisee Obligations- SOPs, Reporting requirements, any compulsions of buying products or other aspects, and Non-compete Clause.
7. Intellectual property rights-Ips, Its grant extends, Protection and infringement clause
8. Dispute resolution- Arbitration and Governing laws
9. Considerations- Earning claims and capital Investments
10. Termination and Exist clause- Grounds of termination, Exit clause and post termination obligation.
11. Risk information terms- Business risk and legal risk
12. Miscellaneous Provisions- amendments, assignment and transfer, and force majeure

Franchisee Contract is amalgamation of the franchisor rights to protect its idea, create his right of the royalty, give right of the franchisee, create the roles of the both party and reserve the profits with restriction on production/ services within the area limitation and granting the rights of area and accordingly give the sufficient earning.

When franchisee agreement is develop the content is not related to one law, rather it is related to 14 types of law Viz, The Indian Contract Act, Labour Law, Competition act, IPR, Companies act/ Partnership acts, Consumer protection act, Income tax/ GST, Banking laws, copy rights and trade mark, Arbitration act and FEMA (in concern with international brands) etc.

While constructing such agreement one needs to also take care of:

1. Uniqueness of franchisee
2. Exclusivity of product / area
3. Price restriction
4. Resale rules and rates.
5. Model of operation, specially marketing and product display
6. Maintaining the position, charges and royalty of franchisee consultant.

These all the above mentioned points clearly explains that Contract law alone is not sufficient to handle such agreement. So, it makes such agreement unique and competitive. So, we are

inclined to place such agreement under the special contract yet out of the scope of contract act. These give the need of giving special concern for creating new law of contract.<sup>3</sup>

So, let's unlearn the contract with special view of making regular contract, under 14 laws and few landmark judgments over agreement issues in franchisee agreement.



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<sup>3</sup> Mentioned in my LLM dissertation at Mumbai university.

## Franchisee Agreement: An Analyses

- Deep Kapadia

“Franchising has been specifically regulated only in very few countries, and India is not one of it”

- Gaurav Marya<sup>4</sup>

Contract Law seems to be sufficient or competent enough to handle any type of contract. But when it comes to Franchisee contract we come into a terrific combination of terms and law.

Franchisee Contract is amalgamation of the franchisor rights to protect its idea, create his right of the royalty, give right of the franchisee, create the roles of the both party and reserve the profits with restriction on production/ services within the area limitation and granting the rights of area and accordingly give the sufficient earning.

When franchisee agreement is develop the content is not related to one law, rather it is related to 13 types of law Viz, The Indian Contract Act, Labour Law, Competition act, IPR, Companies act/ Partnership acts, Consumer protection act, Income tax/ GST, Banking laws, copy rights and trade mark, Arbitration act and FEMA (in concern with international brands) in further chapters it is discussed in brief.

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These all the above mentioned points clearly explains that Contract law alone is not sufficient to handle such agreement. So, it makes such agreement unique and competitive. So, we are

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<sup>4</sup> Franchising- The Science of Reproducing Success, Gaurav Marya, Franchisee India Holding Pvt Ltd. Publication house, New Delhi, P. 130

inclined to place such agreement under the special contract yet out of the scope of contract act. These give the need of giving special concern for creating new law of contract.

### **Need of Research**

Reason for selecting this topic is my work experience since 2008 in the field of Franchisee, and dealing with about 100+ good and bad, small and big and start-up and already booming companies found that their contracts are very narrow and one-sided. As well, it remains incomplete. What we are discussing in this dissertation is not rocket science, but ground work on creating the franchise. This intra-disciplinary dissertation is aiming to assimilate all the aspects of the contract and make it simpler for the practical purpose.

When the world is opting towards the adoption of franchises and daily we see new emerging franchisees. Every month I get opportunity to develop more than 3 to 4 new businesses, to which we lead to franchise mode.

When I take up such task I feel practically many difficulties in ascertaining the rights of franchisee and franchisor, equally I find the difficulty in protecting the rights of both parties and create a stringent but short or long agreement.

Interesting fact is that many clients come to me and ask, “sir, please agreement chotta and crisp rakhyega” (keep it short (less pages) and crisp) yet they need to cover their all rights. Arduous task for me, as once I start typing if I take all the above laws also then it will cross 21 pages and it is too big. Few franchisees who are buying small franchisee are afraid of long agreements even of 21 pages. Just like tea or Frankie franchisee etc. want short agreements while big brands like groceries, Italian joints, café etc. need really detail agreements.

These create temptation that to solve such issues we need a standard Franchisee Contract. It is the need of hour, and practical aspect to be done and approved quickly.

### **Franchisee Contract and other Laws**

This part focuses on how the contract law must synchronize with laws to form the perfect contract. To understand this let us work with each law separately:

**Competition Act-** The Competition Act, 2002 is a law that governs commercial competition in India, preventing activities that have an adverse effect of competition on the businesses. It has well defined the predatory price to avoid the conflict of businesses, and keep healthy business on.

It covers both express and implied agreements (including oral commitments) may be between the person or enterprises. These act work as tool to implement competition policy and to prevent and to punish anti-competitive business practices by firms and unnecessary Government inferences in the market.

While preparing the Franchisee agreement it is must to secure both the parties with competition act clauses

1) anti- competitive agreement clauses:

- a) Franchisee will not enter into any agreement in respect to production, supply, distribution, storages, acquisition of good or provision of services which causes any adverse effect on company or competition with any other business in India. Anything contravening this clause then agreement will be considered void.
- b) Any agreement with other enterprise, company or person at different stages or level of production or operations in different markets, in respect of production, supply, distribution, storage, sale or price of or trade in goods or provision of services, including
  - i. tie-in agreement
  - ii. exclusive supply agreement
  - iii. exclusive distribution agreement
  - iv. refusal to deal
  - v. resale price maintenance

Which is fixed by the e-mail, or agreement by the franchisor and contravention of such clause will lead to penalty which may amount \_\_\_\_% of the earnings/ production/ supply etc.

- b) During the tenure of the agreement and upto of the agreement any event or business done which is adversely affecting the Franchisor or market will lead to compensation for the same. IT also include that the franchisee after closure of the franchisee cannot do similar nature of business till 3 years.
- c) Geographical / territorial limits must be strictly abided.<sup>5</sup>

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<sup>5</sup> Courtesy Einz Consultancy

**Consumer Protection Act-** Consumer Protection Act 2019 is law devised to protect the interest of the consumers, who are end buyers and uses the product or services for self. This act provides safety to consumer regarding defective products or services or unfair trade practice.

In franchisee related to FMCG, or product selling or even in service oriented law it is essential that consumer or end user are protected. It will be always question of fact that who is right or concern person to be sued local agent/ master franchisee/ company / foreign company. These bring in consumer law in prime question while adopting the franchise concept.

While preparing the Franchisee agreement it is must to secure both the parties with consumer protection act clauses:

1. Any of the parties enter into any agreement or buy or sell any product that are harmful to the consumer or fail to give the stipulated services will liable to the terms of consumer Protection Act 2019.
2. Any of the franchisee holds any product which is harmful as per the consumer guidance or any other legal authorities than such franchisee will be hold liable directly. Also, franchisor will be equally responsible for such act.
3. Any price or rates charged in contravention of competitive act or consumer act will liable for the penalty.
4. Franchisee has right to terminate the franchisee within 10 days of the signing of the agreement with appropriate reason and for such termination no charges will be applicable. However, after such period agreement termination will be considered as breach of contract and serve accordingly. (In modern franchisee this clause holds importance under Consumer protection act)<sup>6</sup>

**Banking rules-** It is very essential that franchisor and franchisee both have independent banking operation, but at the same time we cannot have different name account. Also, while notion of taxation one account or one name account will bring the tax liabilities on the company, so to avoid it we need separate operating account for each franchisee with tax liability on the franchisee. For granting such account franchisee agreement must have special option and banking law must grant such probability of account.

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<sup>6</sup> Courtesy Einz Consultancy

Franchisee agreement must hold the following two clauses for the banking operations:

1. Franchisee will be operating all its operation through the account of \_\_\_\_\_ Bank, \_\_\_\_\_ account number with \_\_\_\_\_ IFSC code and \_\_\_\_\_ as operating name. Similarly Franchisor will be operation through the account of \_\_\_\_\_ Bank, \_\_\_\_\_ account number with \_\_\_\_\_ IFSC code and \_\_\_\_\_ as operating name.
2. Franchisor authorizes the party of the second part to open an account with name and fame of <Company name, Branch area name> in the stipulated bank discussed mutually by both parties. Such account can be created with this agreement copy and require document of the franchisee holder for account opening.

Clause no.2 is still challenge in modern banking process, but such provision must be soon provided for the smother transaction and benefit of the franchisee system.<sup>7</sup>

**Intellectual Property Rights- Intellectual** rights are more important than physical properties rights. As it is taking hard painstaking task to develop new concept, ideas and many more things, if such things are infringed it is tough time for business. In the business we have seen that people just replicate the things very easily.

In one of the company we have developed a machine for serving with maintaining the hygiene and nutrition issues. Another person adopted it changed the shape and material of the equipment and started using it, to control such thing is very essential, even certain time marketing policy also need to be copyrighted.

Just a quick review of the Intellectual Property law applicable in franchisee agreement:

- i. **Trade mark-** Every franchisee is brand so they must register there logo and tag line as their trade mark, and this right must be given in which format is the concern of the contract.
- ii. **Copyright-** Name of the brand, even one can rights of the way of the formation of model or product as their copy right and how such copy right can be divided may be mentioned in the contract.
- iii. **Patent and geographical mark-** Incase, of equipment created for the franchisee or any

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<sup>7</sup> Courtesy Einz Consultancy

machine development or any formulae or API development patent must be obtained. Similarly, in case of some special item from the particular area geographical indication must be taken.

Franchisee agreement must hold the following clauses for the IPR protections:

1. All the copyrights and trademark belongs to the franchisor, any infringement will be considered as strict offence.
2. Any devices, software, systems or such other equipment given will be the rights of the franchisor may be patented or acquired and no other such rights will be allotted to the franchisee.
3. Franchisee only have right to use the logo, tag line, any advertises, any other material, equipment, process etc. on the permission and guidance of the franchisor else it will be considered as infringement of Intellectual rights.<sup>8</sup>

**Non-disclosure rules-** Franchisee is being known for its model of marketing and product creation, which is the hard work of the owner of the franchisee and his/ her team. So, such hard work output must be protected and so special rule of non-disclosure term must be added to contract which must be during the period of the franchisee when it is active and also after the closure till particular period it must be maintained.

Franchisee agreement must hold the following non-disclosure clause:

„All the material, information of the business, any marketing strategy/ recipe/ concept, contacts of the client, data of the customer is right of the franchisor and franchisee cannot disclose it, else the repercussion penalty will be levied.“

Or

Party of the second part is bound and binded the terms of Non-discloser of the business pattern including product, equipment and design, income flow and other product margins to outsider to protect the business.<sup>9</sup>

**Arbitration Law-** Dispute does not always arises due to fraudulent activity rather it occurs due

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<sup>8</sup> Courtesy Einz Consultancy

<sup>9</sup> Courtesy Einz Consultancy

to circumstances, and for such reason again and again banging the door of the court become very tedious and expensive matter. So as per the alternative Dispute remedy it is very essential that both the parties go through arbitration process, it will save the reputation and give the quickest reply and for such thing arbitration clause must be added in the contract. As per new policy it is essential that arbitration clause must be added into the agreement without fail.

Franchisee agreement must hold the following arbitration clause:

Any dispute arising out of this Contract, which cannot be amicably settled between the parties, shall be referred to arbitration in accordance with the laws of India. (certain agreement mentions the arbitrator details like name, address etc. in agreement only)

This clause can be complemented with the jurisdiction and language clause which will make the franchisor comfortable to resolve the dispute. That can be as follows:

The Jurisdiction of this contract will be THANE, Maharashtra on any kind of legal disputes in courts

The language of the Contract shall be English Language<sup>10</sup>

**Income tax laws/ GST-** Definitely a good earning brings good taxation and to be free from the complication and problems of the taxation it is necessary to include such clauses into the agreement. Such clause is not about what quantum of tax and which tax, rather it is about who will borne which type of tax.

Franchisee agreement must hold the following tax clause:

Franchisee must bare all applicable taxes and government charges. Franchisee will be paying all taxes and comply appropriately else it can be the reason of termination. The taxes which are applicable on developing the franchisee, buying the stock or required equipment and the taxes applicable on the income will be responsibility of the franchisee.<sup>11</sup>

**Transfer of Property-** If one has learnt about mac Donald then no one can escape his famous statement „I don’t start franchisee rather I acquire the property“ it’s very controversial thought that does it means that we are buying the franchisee to operate in our own property than such property rights are transferred to the franchisor. Answer is simply no, so we need to mention

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<sup>10</sup> Courtesy Einz Consultancy

<sup>11</sup> Courtesy Einz Consultancy

the rights of the property in the agreement very meticulously.

Franchisee agreement must hold the following Property clause:

Any property, its right, expense over the property viz. deposit, rent, light bill, maintenance it responsibility of the franchisee, and no such rights or property is transferred to the franchisor permanently.

Franchisor holds the right of use the property and not any other rights.<sup>12</sup>

**Labour laws-** In both foreign and domestic franchise, franchisor must be aware that when he or she is employing and labour for outlet, restaurant etc. he comes automatically under the sway of apprentice act, contract labour act, Employees provident fund and miscellaneous act, Employee state insurance act, equal remuneration act etc.

Franchisee agreement must hold the following labour related clause:

Any employee or agent or such person hired or employed in the franchisee, the franchisee owner is bided to make appropriate agreement considering following clause:

- a) His/ her payment terms
- b) His/ her tenure
- c) His/ her liability
- d) Any of other terms necessary

Also, such employee is liability of the franchisee, and not franchisor. Franchisee need to see that the employee// labourer hired must be complying the requirement of the franchisor, and if needed be trained and certified strictly.<sup>13</sup>

**Company / Partnership/ LL.P.-** Any person or group of people when star franchisee they must be abide with registration of the group / individual with proper registration, which will certify them to run the business. Such Registration can pvt ltd, LLP or proprietary. This give better weightage for running the franchisee and also give the better stand while selling the franchisee

**Information technology-** World is growing towards the technology many franchisee are modernizing and developing the entire system of the apps and web-portal, and such attempt

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<sup>12</sup> Courtesy Einz Consultancy

<sup>13</sup> Courtesy Einz Consultancy

must be made within the ambit of the Information technology act and avoid the infringement of the privacy or probing in others business, other's privacy, hacking, copying of the project etc. and such rights and protection clauses must be kept.

Such clauses are optional and depends on nature of franchises.

**Licensing-** Every franchisee must be proactive in taking their licenses like adhaar udyog, pan card, FSSAI etc.

Every Franchise agreement can mention the following clause:

It is mandatory for the franchisee to take the necessary licenses for their unit, such charges are above the franchisee fees and terms. Any failure to it franchisor will not be responsible, and may be reason for termination of the franchisee.<sup>14</sup>

**FEMA-** In case of the foreign law Foreign Exchange Management Act is one of the aspects of the franchisee, as it automatically comes under the foreign exchange management law. The clauses are supposed to be implied to adopt the FEMA norms

**Bankruptcy Act-** It is essential to create an exit plan, incase of loss if any company goes bankrupt then it must have a way to secure its franchisee and it can be best cover under the bankruptcy law, the board like IBBI i.e. Insolvency and Bankruptcy board of India who will cover the insolvency and appropriately create distribution of income or take over by the other company, which will reduce the risk of franchisee.

Franchisee agreement must hold the following Bankruptcy clause:

Incise, if the franchisor turns insolvent or the company turns insolvent then it will be executing further as per the Bankruptcy Act of India.<sup>15</sup>

### **Types Of Franchisee Contracts**

Franchisees are of various form and works on different model. Some good companies have direct method of franchising i.e. giving outlet or classes or distributorship etc. But few franchise set the model in hirearchy based that is creating a unit under district/ Area and above them leading to state etc. We are trying to create all the type of franchisee agreement/ contract

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<sup>14</sup> Courtesy Einz Consultancy

<sup>15</sup> Courtesy Einz Consultancy

## Master Franchise

Master franchisee is such type of the franchise, wherein multiple areas are given to the person who buys the franchisee has right to develop the franchisee in the given area and collect the regular revenue from such franchise.

During contract of such franchisee major thing to be controlled are the following:

- a) Rights of the defined area
- b) Rights of the master franchisor in the company like only pertaining to the area or shareholder etc.
- c) Division of the money for developing the franchisee in the said area, revenue on the business, revenue on business growth any other aspects
- d) Relation between master and unit franchisee and its banking formalities
- e) Non-performance clause
- f) Targets and role

## Regular Franchisee contract

Regular franchisee means direct unit such units can be allotted directly by the owner/ franchisor or its master franchisor who is directly given right to appoint in the area. The content for such contract can be simply mentioned in following points:

1. Title and date clause
2. Name clause with address
3. Whereas clause (Recital)
4. Area demarcations
5. Monetary terms (both for buying the franchisee and income)
6. Terms of shop development
7. Roles and development process of both the parties
8. Copy right and other IPR issues
9. Arbitration clause and
10. exit clause

## Administration

Any business success is depending on three elements

- a) Good product line

- b) Good management
- c) Good marketing

When we start growing the business into the franchisee format, administration become the key point, as any loop hole in the administration means giving the loss to all the franchise who have come into the business banking on the franchisor experience, so making an administration contract and plan is very essential. Hence we need to work on the contract of the franchisee administration.

### **Consultation**

Consultation has become a very integral part of the franchisee system. IT is very popular saying that „one never feel any drawback in one“s own work“ to avoid this personal bias, best remedy is appoint or get the advice from the consultant.

It is also essential to appoint the consultant as consultant has wide range of products and network which gives franchisee a quick growth.

Though it is optional to adopt the consultant yet out of 100 cases 98 company have the professional consultant.

The major issue comes in two phases

1. Such consultant are not protected for there fees, though there are contract but such contract have no direct regard to stand and solve cases quickly. And
2. If consultant have taken the charges on the base of franchisee development then in clients contract such elements are not secured.

So there is a special contract requirement.

Conclusion- Necessity of the special contract

After the entire perusal of all the parts, it can be simply seen that the draft of the contract are always seem incomplete.

One can argue that we can make contract which cover all the law. But problems come that it become

1. too bulky i.e. long where in there is danger to the business as many people may get

afraid of the complex agreement and opt out of this complexity

2. too risky as all the laws may not be covered and set in the line with each other
3. too complex to set the network of all the laws

This make us to realize that contract act is insufficient to cover and protect the franchisee and franchisor both, and for such thing as per our research it is time, that likes sales of good act and partnership we need to come up with new law called

### **The Law of Franchisee**

