FRANCHISING DISPUTES IN INDIA – CHOICES DICTATE THE CONSEQUENCES

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This article analyses the factors franchisors should take into account when choosing an appropriate dispute resolution mechanism for Indian franchising arrangements. The author considers the advantages and disadvantages of dispute settlement by Indian courts, foreign courts, arbitration inside India and arbitration outside India. The choice of dispute resolution mechanism can have significant commercial, financial and legal consequences, particularly in light of a recent decision of the Indian Supreme Court affecting franchisors' ability to seek effective interim relief against Indian franchisees.

Franchising transactions entered into between an international franchisor and an Indian franchisee normally provide that the transaction documents are:

- governed by laws of the country chosen by the franchisor, often non-Indian law; and
- disputes are resolved by courts of a specified country (often by courts of the country whose law governs the transaction documents) or by arbitration.

The choice of governing law and dispute resolution mechanism is driven by the need to settle disputes quickly, efficiently and in a cost effective manner, through a fair and transparent legal process which renders a judgement that can be enforced against the parties in question.

Due to recent judicial decisions handed down by Indian courts on arbitration, it has become important to carefully choose the dispute resolution mechanism in commercial transactions relating to India and there is perhaps a case for adopting different strategies depending on the nature of transactions being entered into.

Background

When choosing the dispute resolution mechanism in commercial transactions, parties will consider whether disputes should be resolved by courts or through alternate dispute resolution processes such as mediation and arbitration.

The Arbitration and Conciliation Act, 1996 (the Act) is the main Indian legislation relating to arbitration. The Act is divided into several parts.

Part I of the Act deals with various stages of arbitration proceedings such as initiation and conduct of arbitration and enforcement and challenge of arbitral awards whereas Part II of the Act deals with enforcement of foreign arbitral awards (being awards delivered in foreign seated arbitrations) pursuant to either the New York Convention on Recognition and Enforcement of

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Foreign Arbitral Awards, 1958 (the New York Convention) or the Geneva Convention on the Execution of Foreign Arbitral Awards, 1927 (the Geneva Convention).

In relation to arbitrations to which Part I of the Act applies, Indian courts can grant interim measures, such as injunctions, before, during or after the making of an arbitral award but prior to enforcement of the arbitral award. An equivalent provision is missing from Part II of the Act.

Arbitration clauses incorporated in transaction documents often specify the "seat" of arbitration. The seat of arbitration governs the procedural laws that apply to the arbitration. For example, if the seat of arbitration is London, English courts would have supervisory jurisdiction over procedural matters such as appointment of arbitrators. Choosing a seat of the arbitration does not however mean that all hearings must take place at the chosen seat. The seat can therefore be different from the venue of the hearings. Further, the seat of arbitration can be different from the governing law of the contract in question. For example, a contract between a franchisor and a franchisee to be performed in India can be governed by English law, with the seat of arbitration in India, England or any other place identified by the parties.

Recent judicial decisions

In a significant judgement[1] handed down by the Supreme Court of India (India's highest appellate court) in September 2012 (Balco decision), the Court ruled that:

1. Part I of the Act does not apply to arbitration proceedings seated outside India.
2. If the seat of arbitration is outside India, Indian courts are not empowered to grant interim relief. The court specifically observed that parties which choose to have the seat of their arbitration outside India are *"impliedly understood to have chosen the necessary incidents and consequences of such choice"* [Emphasis supplied].
3. If the seat of arbitration is outside India, pending conclusion of the arbitration, parties cannot file a suit in India for interim relief, even if the suit is limited to restraining a party from disposing of assets in India.

This judgement overrules a previous judgement of the Supreme Court in the case of *Bhatia International v Bulk Trading*, where it was held that Part I of the Act applied to all arbitrations, whether seated in or outside India, unless the parties expressly or impliedly agreed to exclude application of Part I of the Act. The intention was to enable parties to seek interim relief from Indian courts in foreign seated arbitrations, which would not otherwise be available due to the scheme of the Act. However, this resulted in parties approaching Indian courts to apply other provisions of Part I of the Act to arbitrations seated outside India so that Indian courts were entertaining proceedings relating to appointment of arbitrators and setting aside of arbitral awards. Such an overarching application of Part I of the Act not only resulted in increased judicial intervention in arbitral proceedings but also delayed progress of the arbitration, resulting in widespread criticism of the Indian approach.

The decision in Bhatia International was followed by courts in India on numerous occasions and also led to parties agreeing to exclude application of Part I of the Act in foreign seated arbitrations by contract. In the Supreme Court's view, to complete justice, the law declared by the Balco decision applies only to arbitration agreements executed after 6 September 2012 (the date of the Balco decision).

[1] *Bharat Aluminium Co* vs. *Kaiser Aluminium Technical Service Inc.*

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Choosing the appropriate mechanism for franchising arrangements

The Balco decision was received positively by the international arbitration community. However, as is demonstrated below, following the Balco decision contracting parties need to carefully consider the merits and demerits of choosing a dispute resolution mechanism for Indian franchising arrangements as significant commercial, financial and legal consequences can follow, if disputes arise.

In this section, we examine the main dispute resolution options that are available in the context of franchising arrangements and comment on the relative pros and cons of each option.

Dispute settlement by Indian courts

India has an extensive judicial system founded on the principles of independence and fairness. However, there are significant delays and backlogs associated with Indian court proceedings leading to litigation lasting several years or decades before a final non-appealable judgment is obtained. Further, lower courts may not be experienced in complex commercial matters and proceedings or judgements are not confidential. Thus, while the ability to seek interim relief from the courts is a positive aspect of this option, commercial entities shy away from litigating in India due to the time frame involved in achieving a satisfactory resolution.

Dispute settlement by foreign courts

Commercial contracts involving parties based in different countries often confer exclusive jurisdiction on the courts of a specified country to settle disputes arising under the contract. It is therefore possible for a contract between an Indian company and an English company to provide that the courts of England would have exclusive jurisdiction to settle disputes. Such jurisdiction clauses will normally be upheld by Indian courts.

The main issue arising from judgements or orders of foreign courts is that of enforcement. While it may not be possible to enforce interim orders granted by foreign courts in India, judgements of foreign courts can be enforced by using the procedures prescribed under India's Civil Procedure Code, 1908 (CPC). Care must be taken to ensure that the foreign court in question is a reciprocating territory (as notified under the CPC), as judgements of courts based in reciprocating territories are enforceable as a decree of an Indian court, if certain conditions are satisfied including that the judgement orders payment of money. On the contrary, if the foreign court is not based in a reciprocating territory, a fresh suit must be filed in India, which would of course be subject to the delays attached to litigation in India.

Where the choice is between litigating in or outside India, litigation outside India in a reciprocating territory is preferable for the reasons set out above. There may also be a temptation to choose litigation over arbitration, as it may be cheaper than institutional arbitration, though the balance may tilt in favour of arbitration as the grounds for challenging foreign judgements in India are wider than those available to challenge foreign arbitral awards and it would be easier to enforce arbitral awards in India.

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Arbitration in India

It is open for parties to settle disputes by arbitration in India, with the seat of arbitration being India. Arbitration proceedings can take place under the Act, through an ad hoc mechanism or through institutional arbitration, for example through LCIA India (a subsidiary of the London Court of International Arbitration).

In the Indian context, ad hoc arbitration is used more often but suffers from inherent limitations such as lack of availability of arbitrators conversant in commercial matters and the absence of a pre-defined set of rules which increases the risk of judicial intervention. Ad hoc arbitration may also be plagued by delays, particularly where the jurisdiction of Indian courts is invoked as a means of stalling the arbitration process.[2]

As a consequence of the Balco decision, Part I of the Act will automatically apply to arbitrations seated in India. While this will mean that Indian courts could grant interim relief required in support of arbitration proceedings, difficulties may arise if parties seek to invoke wider jurisdiction of Indian courts to delay the arbitration process.

Arbitration outside India

Parties can choose to settle disputes by arbitration outside India under the provisions of relevant national laws, by ad hoc arbitration or through institutional arbitration, for example through the London Court of International Arbitration, ICC, or the Singapore Court of International Arbitration.

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[2] For anecdotal evidence regarding difficulties faced in Indian arbitration proceedings, see the report titled "Corporate attributes and practices towards arbitration in India" by PriceWaterhouse Coopers available at http://www.pwc.in/en_IN/in/assets/pdfs/publications/2013/corporate-attributes-and-practices-towards-arbitration-in-india.pdf

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Following the Balco decision, Part I of the Act will not apply to foreign seated arbitrations, therefore disentitling parties from approaching Indian courts for interim relief. It may therefore be possible for the franchisee to dispose of its assets, transfer its business or take other actions which frustrate the commercial agreements while arbitration proceedings are pending outside India. This problem is accentuated as it may not be possible to enforce interim orders obtained from foreign courts in India and Indian courts are not obliged to recognise interim orders passed by foreign arbitral tribunals. Arguments were raised in the Balco case that by dis-applying Part I of the Act to foreign seated arbitrations, parties are effectively left without remedies in so far interim relief is concerned but the Supreme Court rejected those arguments and observed that any gap in the law must be remedied by Parliament rather than the court.

The above discussion demonstrates that while speed, flexibility, confidentiality and cost would be determining factors for parties choosing arbitration over litigation, in franchising arrangements, franchisors must also consider whether it is necessary to preserve the ability to seek effective interim relief against the franchisee in India.

If the franchisor does not own an equity interest in the Indian franchise, there may be fewer concerns around disposal of assets by the franchisee. However as actions of the franchisee in India could have consequences for the franchisor's business in other parts of the world, particularly where the franchisee is not operating the business to an expected standard or is undertaking activities which undermine or tarnish the franchisor's brand reputation, franchisors would expect to obtain restraining orders against the franchisee. In such circumstances, until the position set out in the Balco decision continues to be good law, there may be little choice but to accede to arbitration seated in India, despite the relative disadvantages attached to such proceedings.

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