FRANCHISING LAW IN PAKISTAN – UNABLE TO PROGRESS BEYOND AGENCY/LICENSE DILEMMA – WITH LIMITATION ON ROYALTY REPATRIATION

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Table of Contents

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INTRODUCTION

Pakistan does not have any specific law governing the issues relating to franchising. Nevertheless, Pakistan's Supreme Court has endorsed the definition of franchise as "a privilege granted or sold, such as to use a name or to sell products or service. The right given by a manufacturer or supplier to a retailer to use his product and name on terms and conditions mutually agreed upon." In its simplest terms, a franchise is a license from owner of trademark or trade-name permitting another to sell a product or to serve under that name or mark. Precisely this definition is more akin to a license rather than an agency."[1]

Of course, the above being a borrowed definition from Black's Law Dictionary, is a far cry from implementing a franchise business enablement and regulation regime.

Therefore, in a franchise transaction covering Pakistan, the relationship between the parties and their respective rights and liabilities are principally governed by contractual arrangements that, by law, are subject to strict interpretation of the terms of the contract, which in turn is influenced by Pakistan's general civil contract law, namely, Contract Act of 1872 (hereinafter 'Contract Act').

IS FRANCHISE AN AGENCY?

Pakistan's courts have attempted to examine franchise agreements as one in the nature of an 'agency', whereby the franchisor can be taken as a 'principal' and the franchisee can be an 'agent'. However, as we will note below that Pakistan's courts have not found the 'agency' concept as the perfect fit.

The Supreme Court has observed in the case of *Bolan Beverages (Pvt.) Limited v*

[1] PLD 2004 Supreme Court 860

Pepsico Inc. & Others (hereinafter '*Bolan Beverages Case*') that under section 182 of the Contract Act, an "agent" is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the "principal".[2]

According to the above definition it appears that an agent is appointed by a principal to do any act for the principal or to represent the principal in dealings with the third persons.[3]

Equipped with the aforesaid understanding, the Supreme Court analyzed a bottling plant agreement in the *Bolan Beverages Case* and noted that, "From the agreement in hand it has become abundantly clear that Bolan Bottlers while dealing with third persons do not represent Pepsi Cola. After purchasing the concentrate from the Pepsi Cola Company they are engaged in a business which is purely their own and the returns thereof are completely enjoyed by them."[4]

"There are a few other sections, which also enhance the phenomenon of an agency. Section 211 of the Contract Act describes the agent's duty in conducting the principal's business. This section presupposes the belonging of the business to the principal while the conduct thereof to the agent. Whether the business agreed upon between the parties before us is the one of the principal or of the agent remains to be determined in the light of the agreement."[5]

"Supreme Court further noted in *Bolan Beverages Case* that, "According to the agreement, the entire business belongs to the Bolan Bottlers and not the Pepsi Cola Company. In the wake of the existence of an agency, a loss sustained by the principal is bound to be made good by the agent. In the agreement before us all the losses as well as the profits are of the Bolan Bottlers and not capable of being shared by the Pepsi Cola Company except for the sale of the concentrate for which a price is fixed and duly paid. In terms of the provisions of section 182 and 211 of the Contract Act, we believe that, prima facie, the agreement between the parties does not constitute an agency either."[6]

The Supreme Court also noted that "Under section 213 of the Contract Act an agent is bound to render proper accounts to his principal on demand. In the instant case Bolan Bottlers, as per agreement, is not bound to render any account to Pepsi Cola Company on demand. Section 216 of the Contract Act explains the principal's right to benefit gained by agent dealing on his own account in' business of agency. It elaborates that if an agent without the notice of a principal, deals in the business of agency on his own account instead of on account of his principal, the principal is

[2] PLD 2004 Supreme Court 860
[3] PLD 2004 Supreme Court 860
[4] PLD 2004 Supreme Court 860
[5] PLD 2004 Supreme Court 860
[6] PLD 2004 Supreme Court 860

entitled to claim from the agent any benefit which may have accrued to him from the transaction. In the instant case, as said earlier the whole business is that of Bolan Bottlers which is run on its own account and not at all for the Pepsi Cola Company. This also prima facie is indicative of the absence of agency."[7]

"Sections 217 and 218 of the Contract Act also lay down certain conditions that the agent is bound to pay to his principal all sums received on his account. In case before us, the Bolan Bottlers never received from the third persons any amount or account on behalf of or for the Pepsi Cola Company. The agreement viewed in the light of the text law, prima facie, indicates the existence of no agency."[8]

IS FRANCHISE A LICENSE?

The Supreme Court has also explained that in its simplest terms, a franchise is a license from owner of trademark or trade-name permitting another to sell a product or to serve under that name or mark. Precisely this definition is more akin to a license rather than an agency.[9]

REGULATION - LIMITATION ON REPATRIATION OF ROYALTIES ABROAD!

We often note references to payment of "Royalty" in franchise agreements. Pakistan's Courts have called the royalty as "A payment reserved by the grantor of a patent, lease of a mine, or similar right, and payable proportionately to the use made of the right by the grantee. A payment which is made to an author or composer by an assignee or a licensee in respect of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent."[10]

It is crucial to franchisors to be able to collect franchise royalties in the foreign markets, where they have invested, created employment and introduced superior goods, services and technology. However, in one instance since 2001 international food chains operating in Pakistan have faced this challenge of not being able to repatriate royalty revenues out of Pakistan owing to a faulty policy of the country, which stands highlighted in this article.

It is the Foreign Exchange Circular No. 03" ('Circular') dated 24th March, 2001, issued by Pakistan's central bank, i.e., the State Bank of Pakistan ('SBP'), that obliges certain Pakistani commercial banks[11] to observe the following:

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[7] PLD 2004 Supreme Court 860
[8] PLD 2004 Supreme Court 860
[9] PLD 2004 Supreme Court 860
[10] 1980 PTD (Trib.) 92
[11] Namely: ABN Amro Bank NV, Al-Baraka Islamic Bank B.S.C., Allied Bank of Pakistan Limited, American Express Bank Ltd., Askari Commercial Bank Limited, Bank Al Falah Ltd., Bank Al Habib Ltd., Bolan Bank Ltd.,

"The remittance of Royalty/Franchise and Technical Fee or Service Charges in Agriculture, Social Infrastructure and Service Sector projects including international food chains may be allowed according to the following guidelines:-

i. The initial lump sum fee payable to the foreign investor/the party providing technical expertise and/or allowing use of their brand name, should not exceed US$ 100,000/- irrespective of number of outlets under on franchise.

ii. A maximum of 5% remittance of net sales excluding 15% sales tax) in the food sector may be allowed as Franchise Fee only for those items which are core items of the franchise and are the specialties of the trade name. The payment of such fees be allowed on monthly basis. No item will be eligible for twice payment of Royalty/Franchise Fee. In other words, the payment of Royalty Franchise Fee shall not be admissible for those items whose franchise is not held by the food chains and/or which are sold under some other brand name e.g. soft drinks etc.

iii. Percentage/amount of fees etc for other non-manufacturing Projects may also be upto the maximum of 5% of not sales (excluding 15% sales tax).

iv. Initial period for which fees be allowed to projects in non-manufacturing sectors including international food chains should not exceed 5 years. Subsequent extension in time period will be considered and allowed by the Government/State Bank of Pakistan provided these projects also make investment in allied upstream projects"

Thus the given Circular, in effect, limits a franchisee's ability, as well as, it's its bank's ability to transfer royalty fee out of Pakistan up to a maximum of 5%.

However, the aforesaid Circular is not a statutory law, as SBP does not have powers to issue laws, rules or regulations. SBP itself is a creation of a statute. At the most, this Circular is an executive order and does not apply to any person other then the Pakistani banks as identified above. SBP derives authority to issues such executive-order-nature circulars pursuant to Foreign Exchange Regulations Act, 1947 (FERA '47).

Citibank N.A., Crescent Commercial Bank Limited, Dawood Bank Limited, Deutsche Bank AG, Doha Bank, Faysal Bank Ltd., First Women Bank Ltd., Habib Bank AG Zurich, Habib Bank Ltd., Hong Kong & Shanghai Banking Corporation, Industrial Development Bank of Pakistan, KASB Bank Limited, Metropolitan Bank Ltd, Meezan Bank Ltd., Muslim Commercial Bank Ltd., National Bank of Pakistan, NDLC-IFIC Bank Limited, Oman International Bank SAOG, Pakistan Industrial Credit & Investment Corporation Ltd., PICIC Commercial Bank Ltd., Prime Commercial Bank Ltd., Rupali Bank Ltd. RBB, Saudi Pak Commercial Bank Ltd., Soneri Bank Ltd., Standard Chartered Bank, The Bank of Khyber, The Bank of Punjab, The Bank of Tokyo Mitsubishi Ltd., Union Bank Ltd., United Bank Ltd., and Zarai Taraqiati Bank Limited.

The given Circular (strictly speaking) is in itself, illegal and invalid under section 4 of the Protection of Economic Reforms Act, 1992, (PERA '92), which, subject to certain exceptions, maintains that "[a]ll citizens of Pakistan resident in Pakistan or outside Pakistan and all other persons shall be entitled and free to bring, hold, sell, transfer and take out foreign exchange within or out of Pakistan in any form and shall not be required to make a foreign currency declaration at any stage nor shall any one be questioned in regard to the same".

CONCLUSION

For the time being the legal approach to franchise agreements in Pakistan is: "What exists between the present parties is more suitable to be determined in the light of the agreement itself and then the relevant laws on the subject".[12] Thus, under Pakistan's jurisprudence, franchise agreements are not agency agreements rather they are license agreements.

Plus, there is currently in place an executive-order-nature Circular of SBP that is limiting the capacity of Pakistani companies to transfer royalty/franchise fee out of Pakistan up to a maximum of 5%, and that such Circular is invalid in the light of section 4 of PERA '92. It remains to be seen as to when will Pakistan's government will wake up to this issue and remove this hurdle to encourage franchise market development in the country.

Thus, the if one is to transact franchise with Pakistan based franchisee's then for now such parties will achieve more certainty in legal product, dispute resolution, and mitigating losses if they are able to avoid subjecting their franchise agreement to Pakistan's law – which lacks a franchise regulation.

[12] PLD 2004 Supreme Court 860