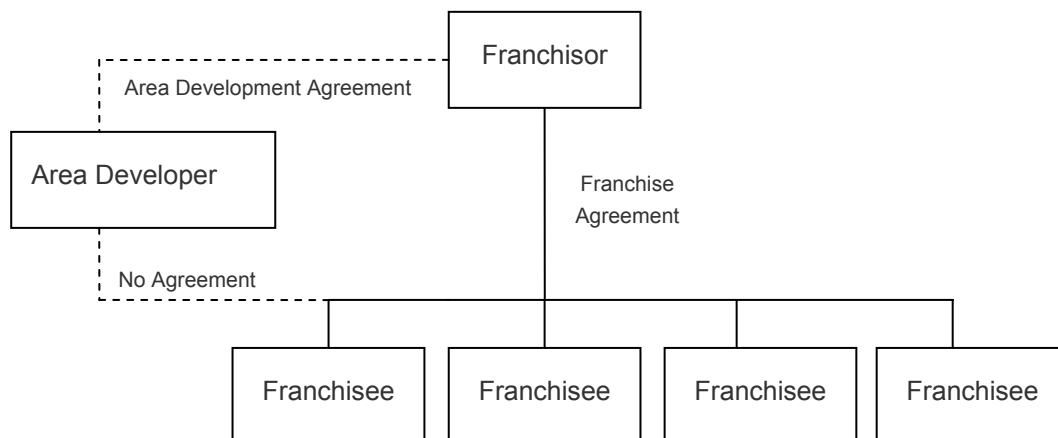


Franchising Glossary

Area Development Agreement (ADA): An ADA is designed to promote the development of a franchise system in a particular area and is not a franchise agreement. An ADA is typically used in circumstances where the franchisor does not have sufficient resources in a particular area or requires assistance with respect to a particular area (typically another country or state). Common duties or obligations of an area developer include the recruitment of franchisees and the identification of appropriate sites for the operation of the *franchised business*. An area developer will not be a party to the *franchise agreement*.



Disclosure Document (DD): The DD provides both prospective and existing franchisees with information about the franchise system regarding existing franchisees, intellectual property, marketing funds, payments, franchisee obligations, earning information etc.

The *Franchising Code of Conduct* requires the franchisor to provide a DD to its existing franchisees and any prospective franchisees being seriously considered for entry into the franchised system. A copy of the proposed franchise agreement in the form in which it is to be executed must be attached to the DD before it is provided to the franchisee.

Due Diligence: An examination of the franchised business and its competitors can provide the prospective franchisee with useful information which can be used to consider the likely success of the franchise and help a prospective franchisee make an informed decision to purchase the businesses. A thorough due diligence process will help identify the risks of the franchised business and permit consideration to the methods available to reduce the risks associated with the investment. Seeking independent legal, accounting and business advice and speaking with existing franchisees are important aspects of the due diligence process.

Franchise Agreement: A franchise agreement is the term used generally to refer to the business arrangement between the franchisor and the franchisee. A franchise agreement is defined in regulation 4 of the *Franchising Code of Conduct* as:

- an agreement (whether written, oral or implied);
- in which the “franchisor” grants to the “franchisee” the right to carry on a business under a system or marketing plan substantially determined, controlled or suggested by the franchisor;

- where the operation of the business will be substantially associated with a trademark, advertising or commercial symbol of the franchisor or franchisor's associate; and
- this occurs in exchange for the payment of particular fees before starting or continuing the business.

Where all four criteria are satisfied, the arrangement is considered a franchise agreement and the *Franchising Code of Conduct* applies (regardless of the title of the document). The ACCC has taken legal action against parties that have described their arrangements as a licence or distribution agreements in an effort to avoid compliance with *the Franchising Code of Conduct* where the arrangement does satisfy the legal criteria of a franchise. (NB: A clause noting that “this Agreement is not a franchise agreement” will not be sufficient to exclude your arrangement from the *Franchising Code of Conduct*).

Franchisee: A *franchisee* is a person to whom the right to operate the *franchised business* is granted by a *franchisor* under the terms of a *franchise agreement*.

Franchised Business: A *franchised business* is a business operated under a *franchise agreement*.

Franchise Fee: The *franchise fee* is the term usually used to describe the payment often made by the *franchisee* to the *franchisor* upon signing the *franchise agreement* in exchange for the right to carry on the *franchised business*.

Franchising Code of Conduct (the Code): The *Code* regulates the conduct of participants in franchising towards other participants in franchising. A breach of this *Code* constitutes a breach of the Trade Practices Act 1974 (Cth) (the Act). The ACCC governs the *Code* and is empowered to consider complaints, investigate alleged breaches and to take action if it is found that a breach has occurred. Franchise participants are permitted to take their own private action for a breach and there are a range of remedies available to the affected party where a court agrees that a breach has occurred. These remedies include declarations that particular conduct is in breach of the Act, damages, recession, setting aside or variations of contracts, community service orders and corrective advertising.

Franchisor: The *franchisor* is a person who grants the *franchisee* the right to operate the *franchised business* under the terms of the *franchise agreement*.

Greenfield Site: A *greenfield site* is the term usually used to describe a site from which the *franchised business* has not previously been operated.

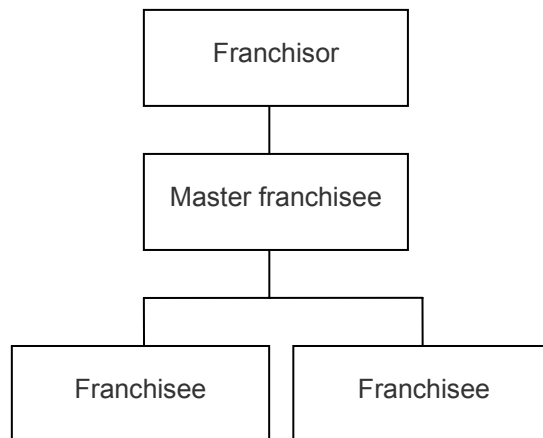
Local Area Marketing: *Local area marketing* is the term usually used to describe an activity performed by the franchisee to promote itself in its local area. *Franchisees* are often required (and it is good business practice to understand the local market and exploit opportunities in the local area to raise awareness and improve local interest in the *franchised business*). Often the *franchisee* is obliged to conduct *local area marketing* under the *franchise agreement*.

Marketing or Advertising Levy: A *marketing or advertising levy* is the term usually used to describe the fee the *franchisee* must pay into a centralised fund which the *franchisor* then uses to conduct advertising and promotional activities of the *franchised business*. The levy is usually charged as a flat fee or percentage of the *franchisee's* sales.

Master Franchisee: In a master franchise arrangement, the franchise is granted by the franchisor to a *master franchisee*, typically for a large *territory*. This arrangement is commonly

used when the *franchisor* intends to have minimal involvement in the operations of the franchise in that territory and wishes to delegate this function to another party. The day to day operation and support given to franchisees is typically provided by the *master franchisee*.

While the *master franchisee* acts as a *franchisee* in relation to the *franchisor*, it is the *franchisor* to its own *franchisees*. The *master franchisee* must give its franchisees a *DD* from both the *master franchisee* and the *franchisor* to comply with the *Code*. The *master franchisee* typically pays the *franchisor* both initial and ongoing fees.



Materially Relevant Event: A *materially relevant event* refers to any event listed in Regulation 18.2 of the *Code* and includes the insolvency of the franchisor and a change in the majority ownership or control of the franchisor. A franchisor must advise franchisees that a material event has occurred within 14 days of the event occurring.

Exclusive Territory: Where the *territory* granted by the **franchise agreement** is a *exclusive territory*, the *franchisor* agrees not to open another franchised or company owned business within the *franchisee's exclusive territory*. (NB: There are often exceptions to an exclusive territory and it is advisable to seek legal advice if such an exception applies in your agreement).

Retention Money: *Retention money* is a sum of money that the *franchisee* is often required to pay to the *franchisor* upon a transfer to allow the *franchisor* to satisfy the *franchisees* debts in relation to the *franchised business*. The *franchisor* usually then returns the balance of the money (if any) to the *franchisee* at the end of a set period of time.

Royalty: A *royalty* is the term used to describe the fee that is usually paid by the *franchisee* to the *franchisor* for the ongoing use of the brand and systems, management and technical support. A *royalty* is typically in the form of a flat fee or a percentage of sales or purchases of the *franchised business*.

Term: The *term* is a common way to describe the period of time that the *franchisee* can operate the *franchised business*. It is common for a *franchisee* to be granted a right to renew the term in order to operate the *franchised business* for a longer period.

Territory: A *territory* is the term usually used to describe the area in which the *franchisee* operates the *franchised business* pursuant to the *franchise agreement*. *Territory* can be a country, state, region, suburb, area shown on a map or area with a particular border.

Transfer Fee: The *transfer fee* is a fee usually paid by the *franchisee* to the *franchisor* when the *franchisee* transfers (eg sells) its *franchised business*. A *transfer fee* is typically a flat fee or a percentage of the sale price of the *franchised business* and may vary according to the time for which the *franchisee* has operated the *franchised business*.

Trade Mark: A *trade mark* is a sign (including any letter, word, name, signature, numeral, device, brand, heading, label, ticket, aspect of packaging shape, colour, sound or scent (or any combination of these)) used, or intended to be used, to distinguish goods or services of one trader from those of another.

For enquiries regarding this handout, please contact:

Anna Trist | Senior Associate | Middletons

Level 25 South Tower, 525 Collins Street, Melbourne VIC 3000, Australia

T: (03) 9640 4381 F: (03) 9205 2055 M: 0409 856 641

anna.trist@middletons.com

www.middletons.com

This material is copyright and may not be reproduced without permission of the author.