Franchise Radio Show

Interview 1 and 2

Essential Elements of the Franchise Relationship

Brian Keen from Franchise Simply Interviews Ivan Poole from Ivan Poole Lawyers

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THE FRANCHISE RADIO SHOW INTERVIEWS

In his 40 years in business, mostly in the franchise industry, Brian Keen has found, chances are small business owners are continually stressing over how difficult it is to grow a business to a level that will allow them to delegate properly and get a life back.

So Brian brought all his knowledge together in his latest venture, 'How to Franchise Simply', with the aim of showing business owners how to transform a family-sized firm into a multi-million dollar asset through a unique four-step system, saving tens of thousands of dollars in consultancy fees in the process. Because he works both in Australia, where he lives, and internationally, Brian's systems apply across the globe.

A core part of this latest venture is to provide training and education about all aspects of running a franchised business. After all, most business owners really do not know what is involved in growing their businesses in this way.

And an important part of the training program are Brian's Franchise Radio Show Interviews with experts in the franchise industry and business. These relaxed and informal 'fireside chats' range across every aspect and are an easy way to start to understand some of the trickier aspects of franchising. Join him as he penetrates the inner-world of franchising with the top authorities in their field. The result is invaluable information that can make a dramatic difference to your business, its short-term viability and long term asset value, ultimately adding significantly to the payback you will receive when the time comes to implement your exit strategy.

These Interviews range across every aspect and are an easy way to start to understand some of the trickier aspects.

Brian's small business ideas are sound, based on years of practical experience in businesses like yours. Over the years he has discovered that franchising need not be difficult or expensive. These Interviews show that it is really just a matter of getting your head around the concept and then taking action step by step.

This small book is a transcription of one of the interviews:

Essential Elements of the Franchise Relationship

INTRODUCTION TO INTERVIEWS ONE AND TWO

Essential Elements of the Franchise Relationship

The question of whether to License or Franchise is one that is asked regularly. And the answer is, in Australia, it is determined by the four point test set out in the legislation.

This interview covers the main requirements set down by the Code which determine if a business can operate under a license or if it is a fully-fledged franchise. A business owner needs to know which structure is most relevant to their needs as well as the advantages and disadvantages of both, prior to the preparation of any legal documentation.

If a business is a franchise, then the relationship between the two parties (the franchisor and franchisee) is largely governed by the Franchise Agreement. And, while the structure of these Agreements is clearly outlined in the Act and Templates provided by the ACCC, the specific contents need to be carefully considered by a prospective franchisor before the Agreement is drawn up.

Clauses can cover a wide range of issues from, specifying territory boundaries, service fees, insurances, plant and equipment, dispute management, communication and more. They can become very complex.

Having the correct legal documentation, which set out how these many issues relate to both the Franchisor and the Franchisor, form the basis of an ongoing and positive business relationship between the two parties.

To provide you with an overview of what is necessary from a legal perspective, we interviewed Ivan Poole of Poole Lawyers. Ivan has well over 30 years' experience in these matters in Australia and overseas.

THE INTERVIEW

Brian
Welcome everybody! Good afternoon. Thank you for coming along to our Radio Show today. I'd like to welcome as well, Ivan Poole, lawyer.

What I'd like to do this afternoon is discuss some of the Essential Elements of the Franchise Relationship.

In Australia, this relationship is largely governed by the legal documents required by the Franchise Code of Conduct which is why I am so pleased to have Ivan here to discuss the details.

Initially, because this is often the first question we get from prospective franchisors, we will run through the question, **Should I or Could I Use a License Agreement instead of a Franchise Agreement**?

And then when that's been completed, we will go through the **Essential Elements of the Franchise Agreement** – the things we would all need to think about before we go to a lawyer to have this document drawn up.

So Ivan, thank you very much for coming along.

LICENCING VS. A FRANCHISE AGREEMENT

So just to start the ball rolling, Ivan, with regards to the **Elements of a License Versus a Franchise Agreement,** I wonder whether you might just outline in simple terms for everyone, what the difference essentially is and how to identify the difference.

Ivan
Thanks Brian and thanks attendees for inviting me to speak and participate.

Basically the first question you need to decide, when considering whether you are going to have a license or a franchise comes back to those four elements in the franchising code.

Clause 4 which has four elements –

First, where you have a written or a verbal agreement or an implied agreement, so that covers most agreements.

Secondly, where there's any money at all that you are receiving, which is not the cost price of training, goods services or whatever it is, so again not too many entrepreneurs will be giving away their ideas or ways to do it.

Over the past decade or more realized the value in brands.

Four includes the two sub-elements.

The need or requirement to follow a manual

Or have a business plan or a system of operating the business. It's actually called a system code, and it's been taken to be something as simple as a manual; even sometimes a training manual, but certainly an instruction manual, how to do the business or where the parties are required to follow a marketing plan, or contribute to a marketing plan.

So if you have four out of those five, then you have no choice other than to follow the franchise code requirements and I suppose bluntly call it a franchise, you can call it a license if you like, and you can still run it as such, provided you comply with the code if you have four or more of those points.

If you don't have four, you may have a license, but if you have those four, then you can't have a license.

So that's the factual sort of makeup if you like of your license.

But the license document very often is very similar to a franchise document. It still has for example things you'd expect:

Such as the **Term**

Obviously parties might have an **Exclusive Territory**

Might have **A Fee** to be paid or fees to be paid.

Use of **confidential information**

All that sort of thing is contained in a license as well, but they are just simpler and needless to say, a more cost effective process.

But if you have a license and you're supposed to have a franchise, the franchisee could be successful and probably would be successful with sufficient legal backing to be able to say, well I should have had a franchise, and you've breached an industry code. It's as though you're either over limit or you're not, so you've breached that industry code, therefore I want all the money back and damages and lawsuits and fees, etcetera, etcetera.

So, that's the downside and ironically since I last spoke to you, I'm pretty sure, I certainly have a colleague in Brisbane who rang me a week ago to see if I could help them because he's too busy and doesn't do much franchising. He has just had someone come to him with an ASIC three months order to take their 25 licenses apart and re-issue them all as franchises or ASIC will pose a substantial fine and they've already been fined once.

In a similar circumstance, I think about six or eight weeks ago, I was actually creating documents for a person who had nine franchises and I haven't heard back from them. Then I heard they've also been given three months to put their business into a franchise.

So in broad terms, the test is really a rigorous one, do I have meet those points, do I require a franchise or a licensor, do I require my franchisees or licensees to have under the four or over the four of those elements.

Brian
Yes, that's interesting. I'm a little interested in these examples you've brought up. I think I've learned from these people.

Ivan
Yes, I'm not sure about the second one but the first one, the licensor as it was, had dismissed a licensee and the licensee didn't believe it was the right thing to do so they went to ASIC and complained.

ASIC wouldn't rule on the dismissal, but they did look at the system and said, 'You're breaching the code', fined them some money then said, 'I'll give you three months to put your house in order. We'll come back and revisit you at another time'.

Brian
Right, so it's fraught with danger and I suppose, if you are operating as a

licensor and you have a licensee, you need to be very careful that you don't inadvertently cross that line and start behaving as if you were a franchisor.

In other words, providing material or having requests which effectively imply that you're running a franchise. If you request a marketing plan for the next 12 months or whatever from your licensee, then you review it and contribute to it, you're really on thin ice, because you may be effectively a de facto franchise.

Ivan
I think so. In fact, yes.

There are people that just say, we want to do a license regardless and we'll run the risk.

There are people who start off legitimately, as you said, where they have a method of doing a business, and offering a service. They license if you like, to other people and then with a bit of growth and so on, they say I'll have a go at this and I'll have a go at that, not realizing they've crossed one or two of those other boundaries.

Brian
What's the challenge in converting a license into a franchise?

Ivan
Well, it's not terribly difficult…some people do it voluntarily.

I've got some people at the moment who are probably going to do it voluntarily because they've been skating on thin ice for three or four years.

Firstly of course, you'd have to get your licenses to agree, then you have to do your franchising documentation and then of course get them signed up. Most licensees would agree if their commercial terms don't change. If it's

as simple as that, if you're being offered supposedly a better product, if you're offered a new car, it's the same car as the older or even better, then you're probably going to say, 'If it's not going to cost me anything I'll do it, but if it will cost me anything else, I'll stay with what I've got'.

So the usual thing is, it has to be sold by licensors who become franchisors to their licensees who become franchisees. So it can be done; I mean as I said before, if they franchise and the franchisees have the same deal as they would have had as a licensee (money, territory, what business you're carrying on and their loss of goodwill and even rebranding fully paid for and so on) then most people have no trouble in converting their licensees over.

Brian
I guess a lot of licensees would see the benefit in the freedom they've got with a license compared with a franchise, whereas others may see the security in a franchise, or that you do have certain constraints as a licensee.

Ivan
Yes, I would think really that the restraints and constraints on a licensee in a well-drawn license agreement are really no different than those on a franchisee.

I mean some people just don't want to go franchising and specifically tailor their business that way. I have a client who is going without and not breeching any legislation, operating in cities across Australia and they have, from inception, been a license, but they can do it. They have a document and they have trademarks, but that's where they stop. The machines are supplied by third party suppliers with whom they have no financial arrangement at all, it's an independent third party. They do the training but they don't have a manual, they don't really care whether their licensees stay open or what they do. They have the trademark, intellectual property and stuff they can enforce, so they have three out of the five if you like, so they're quite happy cruising along like that.

Brian
So in their case, it's more of a product franchise.

Ivan
It's more, it is a service franchise. They just get a flat fee, the whole process is really quite straight-forward and it could equally be a franchise but it's been quite successful and growing steadily, just by being a license but they don't do any marketing for example. They do their own marketing if they want to and they occasionally do, that's the licensor.

Licensees can buy marketing material at cost and they don't require any following of a manual. As I said, it's all to do with the company that supplies the very expensive, $100,000 I think they are, IPL beds so they give the training and the maintenance of the bed and they get a separate fee in the third party agreement.

Brian
Tell me, what would you, if someone comes to you, what would you suggest are the benefits of a license?

Ivan
Well, the benefits of a license usually are lack of complexity, lack of compliance with any code if you like, and of course obviously lower costs. Possibly and probably predominantly, legal fees. Because we do a bit of licensing, we particularly do a lot of licensing overseas. We just finished one for the Netherlands last week for a franchisor, and a month ago we've taken products to the Gulf States. They were all licenses. Sometimes they're to franchise offshore, but they're mostly licenses because they can be simpler. But it's the simplicity of the document and the simplicity of having a 20-page document as opposed to the rather large part of documents you have to have with franchising. But I don't think the franchises suffer. If franchisees do suffer, it's probably suffering from what I'd say and you'd probably ask in a minute, that I feel is quite right here. I think that franchises, as a franchisor business, or a franchisee business have a higher capital gain and higher marketability and you get more for your money when it comes to sell it and so on.

Brian
That's right, so there isn't the same intrinsic sort of building goodwill if you like, in the value of a license

Ivan
Yes, I think the licenses are seen to be just like that. They're a license to do something, whereas a franchise is normally called a full business format or something like that, so it's more than that or it has the bells and whistles if you like, plus more melody.

Brian
It's a long term business effectively I guess.

Ivan
I think it is. Yes, a lot of licenses do as I said maybe for short term, or just there aren't too many licenses. We probably have about 30 franchisors across the country and we're adding them usually every couple of months. And maybe one is sold or just drop offs.

We probably have about three or four licenses and probably 30 or 35 franchisors. More people come to us and say, we want to go to franchising, rather than we want to go licensing or franchising. Some do that, but mostly have already come with their mind set that they want to do franchising and ask how they do it and what are the advantages and disadvantages Elements of the Schedule in a Franchise Agreement

Brian
Thank you Ivan.

Now what I'd like us to do is run through the items in a typical **Schedule in a Franchise Agreement**, where essentially, the variables that you find from the franchise system are defined.

These are the things such as the **Franchise Fees** and the **Advertising Fees** and so on.

INTELLECTUAL PROPERTY

So the first point I'll raise, and not all of you would seek answers to, but in the order they appear in the schedule, it's with regards to **Intellectual Property**.

I think probably Ivan, it's fair to say, this is a bit of a quicksand area; **Intellectual Property** is very broad, isn't it?

Ivan
Yes it is Brian.

Intellectual property is really what the franchisor has which he or they make available to the franchisee, in other words it's what I call in colloquial terms, the 11 herbs and spices.

It's the peg to do it, the ability to do it, the trademarks, the systems and those sorts of things. And yes, intellectual property is very important, and as with brands over the past probably one or two decades, people are realizing that these things have commercial value in the bottom line of both the franchisor's and the franchisee's balance sheet.

So it's important for the franchisor to look after Intellectual Property to encourage growth, to grow by itself, and that's really what a franchisor is all about. It says, look I know how to do this, I'm going to show you and what's more, I'm going to hold your hand through the franchise term and the renewal terms and we're going to go forward together in both. That's the idea of arrangement; franchisor makes money, franchisee makes money and everybody's happy.

Brian
Right.

Now it's interesting, when I signed my first Franchise Agreement as a franchisee in 1982, it was a document of about 15 pages which makes me laugh but the intellectual property it referred to was basically the operations and procedures manual. And all it was really was, was a brand name of a business, 'Bedshed' in this instance. I was just a retail bedding store and there was a paragraph. These days of course it covers a much broader spectrum doesn't it, because there's so much information and data and material license which are considered intellectual property?

Ivan
Yes, exactly.

I'll say, just to summarize in the schedule I sent you, which is just typical list for any of the franchisors we act for, and as you know there's quite a few, they number in the tens.

We put in everything we can to protect the franchisor but at the same time this list lets the franchisee see what the franchisor has. So you'll have things like **customer lead call centre details**, those sorts of things, about which you're perhaps a bit more particular. But it's to make sure that the franchisee doesn't say, "Well I only got the name to use and everything else I'm going to take off." It's also as I said, to protect both sides so that they know that the franchisor is saying, 'We have this intellectual property we've developed, sometimes together and it forms part of what as I said is the basis for the business'.

Brian
And it's interesting, it goes well beyond just what one might consider documenting a design and instruction manual. Because it includes things like customer lists, supplier information, even customer leads and referral processes, it actually covers a fairly wide area in order to basically avoid anyone leaving the system and being able to exploit any of the knowledge or indeed copy any of the material they've seen.

Brian
Okay, let's put you on the spot then. What's the second step?

Ivan
Well that is true, it's also of course for other competitors of the franchise system. Both other franchisees, but principally other franchisors who say, "Well, I'm going to copy this…" and the franchisor can say, "Well, this is how we have it, this is how we prove it in the timeline. We can share, we've got this copyright material formed on a certain date etcetera, etcetera recorded here in our financial agreements..." and so on and so on. So from a franchisor point of view, yes it's important to have it recorded as much as you can, you'll see that in a column with lot of the phraseology and in the

Schedule. We will always put in a generic sentence 'and any other intellectual property which might in time become the property, or for the use of the franchisor' So if during **The Term,** (**The Term** here being the period of five or ten years, whatever it might be in the franchise), the franchisor decides to or does develop some new intellectual property or enhances or has something similar existing, the new stuff is classified as intellectual property. So new things are automatically collected without having to change documents all the time.

Brian
Oh I see. So, as the system improves, something new is incorporated and it's automatically covered under that.

Ivan
Yes, it's the same with equipment goods, plans, those sorts of things, we always add those types of generic sentences at the end, so you don't have to rush back to your Franchise Agreement and add new items in your equipment lists. We had drills and a grinder, but we're now putting in a lathe or something. I'm just being a bit ridiculous with my examples, but that means that when the events change, your agreements are simply sent out in a manual, or online in the manual, but now our equipment is XYZ or something and that automatically is included in the franchise agreement by its inclusion in the manual or in the list.

COPYRIGHT

Brian
Right.

Now something that people often are a little confused by, is the law on **copyright and developing new material,** whether it's manuals or different items. What actually is required in order that they qualify for protection under copyright law?

Ivan
Yes, well thanks for that question.

It's one that you could talk about for hours, although we only have two or three minutes. Don't believe the old wives tales of saying that I'll rush off to my solicitor, and I'll show him my sparkling new book or poetry that's going to revolutionize the world and make me wealthy, and he'll sign off what's mine and charge me $500 and I'll be happy. That means something else is buried in the backyard with a local paper of the day and someone digs it up and says "it must have been there all that time because the box is sealed."

All of that is nonsense, there's no legal procedure anywhere in the world for copyright. In copyright, except in the property of the person who creates it says, I'm now looking over this beautiful Gold Coast Broadwater, out at the ocean, and if I say that the blue sky makes my heart feel happy, and I publish that, and it's on the news tonight. Then someone picks it up tomorrow and says, now what works where your heart is happy or something - I'm just being a bit ridiculous, but I can say that's mine because I've invented that yesterday. It's a novel thought, and therefore I claim copyright and that's for 50 years, and 50 years is the longest you can claim copyright. Hence you'll see Beatles songs and so on, and those sorts of things, they'll say in the paper now that they're coming out of copyright, that means that they're then available for sort of general usage and distribution, without quite so much protection.

So when we do documents, for example when it comes from this office, and we've been doing this for more than 40 years as you know here in Australia, we put a copyright warning on our work, and we put copyright reserved in a code at the bottom of each page so that then we can show people it is of our doing. So if you're the franchisor and you're doing some work that's capable of copyright, like computer software or something, we'll tell you to put a code on that and the date that it's created, etcetera. Also keep your source code, so that you can always go back and say, well here's the date it was created and here's the material showing where it came from. There's no registration procedure, as of course, opposed to designs, patents and trademarks. It's just simply created and the basic example of all that is to just take any novel for example, and just open it up if it's a book or it's a hard copy, open it up and you'll see a copyright warning in there saying that this is protected under the provisions of the copyright act in whatever country it might have been created. It then goes on and on about unauthorized usage. It's the same when you view your DVD or Blue-ray, whatever it might be, it has the same sort of copyright warning.

TRADEMARKS AND PATENTS

Brian

I'm with you. Now you mentioned something there which is of interest to alot of people, and something that can be an expensive exercise. That's the registration of trademarks and patents. What's your suggestion, particularly to smaller business people just starting out in their franchise and who perhaps haven't registered a trademark and yet have a design a logo or something of that nature?

Ivan

Yes, thank you. Well there are four types of intellectual property worldwide.

One is copyright and we've dealt with that.

One is patents

One is designs

One is trademarks

Trademarks over the last decade and a half have extended to sight, smell, sounds, plant, bridges, rights and those sorts of things. So it's not just something you draw or you look at, and say it's the BP sign or it's the Woolworth's Fresh design as an example of trademarks.

Most franchisors don't have **Patents** on their products, probably only one in every hundred. I happened to be with a client I'm involved with from offshore today.

He's here for the day and he in fact has a patent on a couple of products.

Patents is a new area, I can't comment on them too much because it's like being in medical spaces, you have to be a patent attorney. But basically patenting isn't as easy as it was, it's still quite expensive and quite difficult. Processes are not included because they are covered by copyright, for instance a recipe or a manual that's capable of copyright.

But the thing I was talking about is a skip bag which is made out of polypropylene stuff, whatever it is and then lined with other materials and because of its structure and the way its supported, it stands up by itself and it's got a product name called Aussie Skip Bags. This object is under a couple of patents.

Designs are very similar and very, very, very seldom would you see a franchise product or franchise service that will be covered by designs. This category is going to include anything from a tractor or a drug line and mining, right down to a safety pin, so they can be a service but it's usually a product which is covered by Design.

So Trademarks and Copyright are the two principal types of Intellectual Property you find in most business, as well as franchising of course.

The trademark procedure is really quite simple, we do a lot of it here; always have. In fact up to about 10 years ago, I used to do barcodes trademarks all around the world, but now they've got in house people in mist places. But we do a lot of Australian-New Zealand Trademarks. Probably two or three times a week we lodge Trademarks on 45 classes.

And without getting too off the point, mostly, you only have to register in one or two classes. There are 10 classes of services for example in the real estate, medical zone and then there is the business zone which is very wide which is 35 classes.

And if, for example, you're selling clothing, it would be 25, so it's clothing, hats, footwear, headwear, and etcetera.

So, just as an example, if you're a clothing franchisor, you would probably only have to have a couple of classes in Australia. I won't go on with this too much but all going well, you can lodge in a class or you can lodge in a couple of classes. You get your trademark registered and, with legal fees and the application fees that the government sets, for 10 years that would cost around $2,500 to $3,000 for two classes. And that's not a huge amount, in fact it's minimal for the value that you get, because you then have that trademark for 10 years, and automatically, without going back to lawyers and things, you'd pay a fee which is currently $250 per class and you get another 10 years.

Brian
Oh I see.

Ivan
You can spend $3,000 or $4,000 today in dollars and have the trademark for 20 years which for cost at the time, could be a very substantial value depending on your business.

Brian
Now a lot of people don't go to the point of having trademarks registered and, as small business people, probably sole traders that may be fine. But once you go into the market place and you're exposing your product and creating the value in your intellectual property, it becomes quite a different story, doesn't it? Ivan

Yes it does.

Actually people get a bit confused and it's unfortunate for the system in Australia. But if you remember this, in terms of importance for protection, the trademark is number one, the company name is number two and the business name is number three. People usually register a business name as protection first, obviously I've just sent that to the bottom of the ladder.

Trademarks give you, not only the right to build on that brand or that identity, but also gives you the right to say to someone you are 'passing off', which is the legal terminology, you are passing yourself off as me so please stop.

So if you have a trademark and I think well, 'Brian's got a trademark for his franchise now, it's the time you registered that'. And I rush around using your trademark then, you can say to me, 'Stop and desist as it were, or I'm going to sue you.' And if you were successful, and most times you would be, you could also get all the profits that I've made from using your trademark.

So trademarks have immense power and people, particularly in the last decade or so have realized that trademarking is very, very important to franchisors. And we can do that for people of course.

Franchisors should have a trademark when they go to the market as a franchisor, even if it's in only just the process of being applied for.

Brian
Right, I understand. Alright then you for that. It is a broad area and certainly one that's worth getting clarified with an expert.

BUSINESS NAMES AND THE REGISTRATION OF BUSINESS NAMES

Brian
We've touched on intellectual property and so forth. And so we'll move now to **Business Names, and the Registration of Business Names** which is something that sometimes is confusing for people from the point of view of getting protection nationwide.

For example, in the early days of a business the registrations that you need to do, either with all of the individual operators, or the promise of their trading as or by forming a limited company and protecting the name nationally that way. What are your views on that from the point of view of a new franchisor?

Ivan
Yes, unfortunately Australia, because of its State system, has an extra leg not found in other places but, people should remember that the predominant or the most important thing to get is your trademark or a trademark with a name of whatever it is.

Trademarks take precedent over business names, so the business name is really worth nothing.

But you do, as you quite correctly say, have to apply for Business Names in Australia. It is not expensive, but you do have to have an address and most have to say you're opening within three months or six months or something like that. On average there's something like a three-year fee and the application can be done by the business owner. We have lots of clients and very few ask us to do it *as* it becomes too expensive for us to deal with this easy registration but you can do it yourself. I think it's about $300 for three years in nearly every State.

A franchisor should register in every State but a lot of them don't and then they find they want to go in a couple of months or a couple years' time, to Victoria for instance.

We have a franchise that expanded and some of them have already registered the business name but not all.

Had they had a trademark, and we're able to put enough pressure on, say if we have the trademark for that name removed, but it was an unnecessary step when they tried and got the business name. Most people have relatives and that sort of thing in a state to use as an address and I don't want this to be repeated but, I know that the Office Of Fair Trading don't have people going out every three months and knocking the doors saying, have you started a business yet?

But we've got one or two people who have in fact just this year, asked us to get their business names in each State. So we did seven or eight states in one day at the cost of about two and a half thousand. So over a couple of days, they're all there for three years, and they said they're ready to go and that's the best practice but it's easier said than done sometimes.

Brian

Now that's interesting because the case study that always comes to mind for me is Hungry Jack's which of course is Burger King in the US where it first came from, but they couldn't register that name here.

Jack Cowin, when he established it, found that somebody else already had the name registered so they had to come up with another name which is quite interesting. I know when I was at Bed Shed, the retail bedding group many years ago in the early eighties, we couldn't operate in Queensland or in the Northern Territory with that business name because somebody had it registered, so we changed the name to Bed Post. So it can be quite an inconvenience because you're marketing material and so on and so forth and the brand becomes lost in the consumer's eyes. It is important.

Ivan
It is and it's just unfortunate, it's just the situation because of the states in Australia. If there weren't any states, for example such as in New Zealand, it would be a lot simpler in a lot of ways.

New Zealand doesn't have a registered business procedure, so people over there can register themselves and then the someone in the town down the road they doesn't register – they just hang the name up. I suppose it is then subject to the party that was there first, to say you're passing off as it were (that's the legal term we use when you're operating under that name but not actually that entity).

TERRITORIES

Okay moving down the list, there are a lot of small issues which get addressed and which often vary in descriptions of the business from company to company, but there are some issues that pop up so often that I think warrant a little bit more discussion.

Now one of those is **The Territory**. There's a vast range of opinions about territories and a vast range of methods of calculating territories and also a lot of potential dispute. They can cause a lot of dissatisfaction amongst franchisees, because of the management of the operation of the territories, where people perhaps tend to sometimes work outside their territory to the cost of someone else. So the definition of a territory is quite critical isn't it?

Ivan
Yes it is. I mean I was with a franchisor yesterday in Brisbane, a potential new franchisor and they actually have a consultant who's been helping with them for some time, who's sort of an accountant with a bit of franchise knowledge. The accountant said they're against territories.

I always think that a map is the best way of defining them because postcodes can change. People say postcodes, but really a map is something you could look at and say, well I've got the edge of this road or in fact it's easy to find because it's in the middle of the road, the middle of the street, and the middle of the line or whatever. And so I can say this is mine rather than saying, where is this postcode because a postcode is not objective if you take them out of the yellow pages or something, they're very vague. It's no use saying the suburb of this, or the township of this, because again, people don't know where their boundary is. So maps are the best. The question then arises out of that, which again we can talk about for hours with different views, is whether it's exclusive or semi-exclusive. Whether you can operate outside your territory as a franchise, and all sorts of things. What you choose, I think depends on the type of franchise. An example I dealt with is a Call Centre and the territory is automatically routed around as it were, a call goes to one and if you're not available, it goes to the next one and so it goes on a module and if they've got 50 franchisees, they keep on rotating.

Some franchises don't have a territory. Mortgage Choice for example. They have an area in the Gold Coast where we're situated where their first franchise runs at the moment, I think until January 2015. They will only have nine franchisees in this area, so there might have been one or two when they started here six or eight years ago, and they're gradually filling it up.

So there are all sorts of options, and as I said to you, and you know as well as me because we've been in the industry about the same time, I talk to people about the practical things that we're talking about at the moment. The negotiable things if you like, particularly at the franchisor level, the rule is there's no rules, it's what works for your industry, it's what's going to work for the franchisee, it's what's going to work to get this business up and out on the road and to be able to start and recruit people.

Brian

Exactly, and you made a good comment there, that there are no rules which is precisely why you need to be very careful in developing the system for a particular franchise in order that you can lay down the pathway I suppose. You've got the definition of what you can and can't do because otherwise, there are very broad interpretations and territories is one which needs to be considered carefully.

Often in the past I've seen people make the mistake of granting very generous territories, particularly in the early days, perhaps negotiating to get the first precious franchisee on board. One thing the franchisee asks for is, maybe an extended territory or something of that nature. It doesn't seem to cost the franchisor anything at that point in time, but it's a decision as the business grows, which can put them under a fair bit of pressure and certainly lose potential income, isn't it?

Ivan

Yes, I think that's exactly right. I have a case where, probably the best franchisor I've ever had, a warm franchisor. This chap started and nine years later went from nothing to $40 million. He sold his business in about five years to a public company.

But he actually sold his first franchise on the Sunshine Coast. He was operating the business on the Gold Coast in very small premises and doing very well. So he gave his first franchisee the whole Sunshine Coast. Within six years, to keep on top of things, that area was divided into four different territories, subdivided by the franchisees who owned the first big area.

The good point there this franchisor was a very, very good worker and had the ability to work very well with his franchisees and so they worked together to cut up the market and so the franchisor got an extra franchisee. He also received a transfer fee and the franchisee, I think by the time one has been sold, he had his initial fee back. In fact, he initially paid $75,000 and when he was bought out $130,000 and he was paid over 300,000 to go public. So the areas can be subdivided but, you're 100% right, the best practice is to really work out what your market needs to be ultimately and what does a franchisee's market need to be, to have the necessary income.

Brian

I've certainly seen that it's been common for people when they're starting to offer very generous territory areas, and then realize after a period of time, they've actually given away the farm. They then don't have the ability to be able to subdivide and so forth to bring in more franchisees, in particular if a franchisee is not totally utilizing the whole area.

Ivan

Possibly, I know it's a bit pie in the sky but, most people know we acted for the largest dog washing business in Australia for about 14 years. They sold for some millions a couple of years ago. When they started, their territories were at 40,000 houses, but within about three years, they worked out that 15,000 houses was enough and they would aim to wash 5% or 3% of that, and you've got more than enough to do in a 50-hour week.

So it is a bit of trial and error but if the franchisor knows his or her industry, they're usually capable of sitting down and working our fairly accurately where the market is and what will constitute that market's efficiency and the franchisee in a reasonable return plus living.

Brian

Yes, there are instances where, not unlike what happened on the Sunshine Coast, where someone has a territory and there may be some provisions within the agreement that it can be subdivided. Particularly if it's a fixed position like a retail outlet where it maybe in a small town or a suburb or the shopping Centre, then the business is busy or may not be that busy and the franchisor makes an approach for that territory. They subdivide it and that can lead to a few difficult negotiations, can't it?

Ivan

Well it can, but I've got one at the moment with a coffee shop where the location has been a bit difficult, we reckon, for the franchisee, and the franchisor is not helping at all, to try and find a new shop.

Not quite the same position, but you do have people like Price Attack for example, who are very, very hard franchisors, (not to be repeated). We're continually in battle with them against franchisees around the country, and they have an attitude that we'll put your shop here as a franchisee, and we'll open one right next to it if we want to. That's enough to put most people off and it's not that the price is necessarily that good.

When I'm talking to franchisors about getting started, I say, "Look, you've got two hands. You got to have a knife in one hand and you have it in the franchisee's stomach and you have the other hand around patting his back and making him feel warm."

Because if you've got to be firm, you've got to have a firm document, you've got to have firm control, you've got to be prepared to teach people and so on and so on.

But you also need to know when to say, 'Look that was well done' or, 'This is great' or 'You've done well here so let's expand this. So let's talk about cutting your territory down because it's too big', etcetera, etcetera rather than putting their heads in the sand. In the agreements that we have and, I think in common with most, they allow the franchisee, with the franchisor's permission, to cap their area off. On occasion in the early stages, Brian as you would know as well, it's a bit like some spots on your body, they don't all join necessarily and so sometimes you find the franchisor, if he's got a circle or an area or whatever that might be, with some dead ground in the middle and, someone else might have some dead ground. So that might have been working that territory under some arrangement, but then the franchisee decides, well I could use a little bit of this dead territory, and some of yours Brian and some of yours Ivan, and create a whole new territory. So the franchisor will work with him to fill the area up as it were.

Brian

Actually what I like about the time I spent speaking with you Ivan is that you've got a lot of experience with a wide range of franchisors, so you've seen a lot of the issues that pop up. I think it's not necessarily difficult to acquire a franchise agreement or to get some suggestions. But it's important that the people you speak to in all aspects of franchising, particularly the legal area, are conscious of the likelihood of, disputes and things or coming off the rails, which can happen for a whole manner of reasons as indeed with all endeavours in life.

Ivan

Well I think Brian your approach and my approach and the people in this office, who I look after, are very commercial. Because one thing you don't want, that happens occasionally, in the sort of conveyance type of field or whatever where you have a lawyer who says this is wrong or that is wrong, we won't be in here, we won't do that. So you've got to be flexible and most importantly the big word is you need to be commercial.

You've got to try and use every effort to get the commercial deal that your client brings past the line, because we are franchisor solicitors, we're here to make our clients wealthy, we're not here as criminal lawyers might be, to keep them out of jail or whatever. We're here to make them wealthy and we have to get on with the job. If we're continually slow getting it off the line or whatever then there are problems. And that does happen, I've seen or I've heard people say, 'It takes two to three weeks to get documents out of my lawyer', Or otherwise the franchisee will be five weeks, sitting at a solicitor's desk while he is a family lawyer and off doing something else. In one example, he couldn't wait any longer. So you need to be dealing with people who are commercial and also as you said, who get on with the job.

TERM OF THE FRANCHISE

Brian

Now the next item that I've highlighted is the **Term of the Franchise**, in other words the period that the Franchise extends for.

I often use the analogy of a lease, which people are more commonly used to, in as much as it's like a franchise agreement and some of the other aspects, it's totally open. The terms are really up to you, it comes back to what is commercially practical and, from the point of view of the life of the franchise, what's likely to be worthwhile.

But there are a lot of considerations, aren't there?

Ivan

Yes, I couldn't agree more, certainly in something that has plant and equipment for example, or that coffee shop for example or retail. We act for a couple of restaurant chains similarly, five years are needed to use the life of the plant and the equipment and by that time, the place needs a do-up or even a colour scheme change, or whatever. There's the no-rules principle, the person I mentioned previously who sold for 40 million to a public accompany and who unwound the franchise actually had one franchisee with five terms of ten years each. And I know I said to myself, 'I won't be around in 50 years' time nor would you', because he's sort of my age and he didn't even get past nine years.

But normally it's something like five years with triple rights of five.

Five years is quite good because it allows a number of things.

One it allows the franchisor to introduce the new current franchise agreement. Because franchise agreements do evolve just like anything else. There's different ways of doing things, and different methods to 10 or 15 years ago, and I don't really remember a transfer fee or possibly there's not even a renewal fee. Now these things are very much the order of the day, so the franchisor receives those fees when the time arises.

So if you have too long a term, say 10 years, it could be that you're missing out as a franchisor on some of the fees.

Sometimes there's not a formula for increasing say the service fee or sometimes it's the royalty, again you could have that fixed for five years if it's not tied to income or whatever. So five years is a really good time, and then two or three rights of renewal because it doesn't cost the franchisor anymore to say, 'I'll give you those right of renewal'. But the warmth and stability it gives the franchisee is great, because the franchisee might think, 'Well it's going to take me six months or years to sort of learn where the pedals are and to actually make some profit and get going, then I've got only four years left'. Or they might look at it and say, 'I want to sell at some time,' and if it's three or four rights of renewal and the franchisee can exercise those. Very often, franchise businesses will turn over in two, three or four years which are just sort of on average I suppose depending on the industry, so five years plus three or four rights of five is pretty typical.

Brian

Yes, now there are some interesting aspects one needs to take into account and I mean we look at long term, we talk about three, four or five terms or five years. However, there has been a history with some groups where they wanted to buy back the franchises and become a corporate entity again. The famous case I remember, was some years back now was with Pizza Hut when they de-corporatized and de-franchised and there have been other fairly high profile instances as well.

So one needs to be really sure about your term goals I suppose, if you have the ambitions of making it into a corporate company down the tract.

Ivan

Yes I suppose. Not too many franchisors do that. Pizza Hut was a multinational buying up the Australian side of things and now of course they're back into the franchising game but it doesn't happen very often. Franchisors don't usually buy back businesses of even just of one outlet, unless there's really a market for it or it is very reasonable or there are other circumstances that suit them to buy.

That's another mindset that the franchisor has to change, from working in the business to working on the business, and standing away from it and assisting the franchisees and managing the franchisees. So again most franchisors that try to fiddle in the two sides don't make a very good job of being a franchisor.

LEASEHOLD

Brian
Another point which again comes up frequently is **The Leasehold** area, and the point which applies perhaps even more so in franchising, is when it comes to renewal, what are the terms and conditions.

Renewal of the lease is sometimes seen as an opportunity, often mistakenly by a franchisor if he's not totally satisfied with the performance of that franchisee, to avoid renewal or to apply the termination.

What's your view on that?

Ivan
Well, look I say that to franchisors and I'm talking to them all day every day. I don't say the same comment, but something along the lines that it's a pretty brave move.

Most franchise agreements will give the order you have to use to give notice these are the usual types of things.

There was actually an amendment to the Code last year in July which makes not granting the franchisee a renewal even more difficult.

But, remember, in most instances, if the franchisor wants the franchisee to stay on. But if they want the franchisee to leave, then they can follow, if there's grounds of course, the usual procedure for breaching them. Most franchise agreements state that at the renewal time, and the time of doing the latest which is usually something like a minimum of three months earlier, that the franchisee must not be in breach of the agreement. This is the case with this coffee one I was talking about before, the 28th August is three months before the clients are will be breached, because they're months behind in money. So the franchisor is not really getting too excited about trying to find new premises if the clients can't find some pretty substantial money or breach an agreement with the franchisor, they're going to be in breach, so they will not be able to exercise their right and will lose a very valuable franchise business which has been turning over more than a million a year at 1.4 in a shopping centre just out of Brisbane.

So there's a lot at stake but some franchisors can't wait for them to come up to renewal because they're not going to renew. I have to say a lot of that's just sitting in the heat of the moment.

What we put in our agreements again is fairly typical or it should be, so the good faith clause thing says that the franchisor, at the time of renewal, will have the right to increase fees, etcetera, etcetera, etcetera to the then current level, by using the then current agreement, which I said before but will not change the territory. So you can't take that as an opportunity to say, well I'm going to renew or I'm going to take half of your territory and sell it off to someone else.

Brian
Yes exactly, I think there's a lot invested in this because the goodwill of the franchise is often related value wise by an accountant, as being how long they've got left in the term of their agreement and so there's a lot hinging on it.

Ivan
It is, you're quite right. Yes.

Brian
The other thing is, being conscious when you're setting those terms and the number of them is, what's anticipated at the end of the term.

This is a question prospective franchisees ask. Probably one of the most common question is, 'What happens at the end of the franchise?'

And that's something where it has been referred to a number of times in different inquiries and more recently in Western Australia where there's a bit of pressure as to what rights the franchisee has.

Ivan
Sort of disappeared short term.

Brian
Yes, exactly.

Ivan

Well the short answer is blunt. The franchisee on the 31st of May might have a franchise. But if it expires at midnight that night, on the first of June he has no business so therefore no goodwill.

It's as simple as that. He doesn't have a right anymore to use the 11 herbs and spices as I call it, the intellectual property, confidential information or things that he did have access to before such as the supply chain and so on.

So depending on whether he or she or they own the business, in the sense of owning the premises or the lease or whatever it happens to be, they might have a location.

But you know it's as blunt as that.

Obviously with restraint provisions and bits and pieces that might exist, as I've said before, once the franchise agreement expires, if it's not renewed or it just simply is gone through all its renewals and the franchisor doesn't want to start up again, then the franchisee doesn't have any right to continue operating that particular business.

PLANT AND EQUIPMENT

Brian

Right. Now the next one is plant and equipment. We look sometimes at authorized equipment and so forth, particularly where you may be referring to a specialist business of some kind, where particular tools or equipment are required. It may be software or hardware, it may be vehicles or machinery, are required to operate the business. This is an opportunity to actually schedule those But what sort of detail do you suggest people go to Do they include the pencils and the erasers and the drawer and the post-it notes, or?

Ivan

No, not really. I mean look, the simple way we divide it up is authorized equipment- franchisor supplied and that means from an authorized supplier, so the franchisor might supply who knows whatever the equipment happens to be. Then franchisee supply is a separate division under the same sort of heading, and that might then say office records, that's being A, B, C and D and so on. But as I tell people, with the franchisee list you shouldn't get too caught up in the chocolate biscuit clause, I can't say what sort of biscuits or what, what type of paper they have in their printer or in their copier.

And with the authorized equipment, really just say that they must have, let's say a computer for example, of a certain specification whatever. Or it might be that they've got to have a particular type of machine and authorized equipment is usually quite important. We act for the Leather and Vinyl Doctor across Australia and they have about 2 columns of authorized equipment and authorized goods because their colours and things are very, very important, their pigments and so on and so on. All of their tools and some of them are so-called secret tools, are in a separate section. But it's important to have authorized equipment and authorized plant and all sorts of things fairly well detailed. So again, the franchisor can say, well look, I haven't pulled your franchise here, you are using some equipment which is not authorized, and we're going to breach you.

Brian

You mentioned there are authorized goods, now this is an area, very often which, certainly in the past, has led to many disputes. There may be a particular product which may be produced by the franchisor for instance.

It may be acquired from a third party, but the franchisor has negotiated contracts and so forth.

This extends as far as the McDonald's chain, with their hamburgers for example, where they have partnerships with the firms that grow the cattle etcetera, etcetera. But also a lot of franchise groups may have a particular product, it may be a cleaning product or a range of products, that sort of thing, and the point of contention sometimes is, 'Well look, I'm paying XYZ now, will I be paying you $5 a bottle for this, or I can go and buy some from Aldi for far less or go to the wholesalers for $4.50. Why shouldn't I?'

What are the sort of issues surrounding those types of questions?

Ivan

You're quite right, this is complicated and yet simple. The Trade Practices Act of 1995 which is now -I don't know why the hell they changed the name, it doesn't change anything else The Competition and Consumer Act, basically contains in two or three provisions, 45 and 47, I think 81 are the three, which say you can't have what you quite correctly said. This is called a third line forcing or monopoly arrangement.

So third line forcing is where you say to me as a franchisee, you must buy your products from XYZ and XYZ may be in whole or in part or not at all owned or influenced by you and an arrangement will simply say, where you say you must buy it from me. There are two ways of getting around it legitimately and legally. One which very seldom happens, is to get an exemption and we do this about once every year for a franchisor or you can actually go directly to the ACCC and seek an extension yourself.

We have one example, where a very large pill making company or pill importing company, probably the largest producer of weight loss products in Australia didn't want to franchise. But the company has all the other aspects which make them a franchise.

So we applied for an exemption for them, so that they don't have to be a franchise and they can deal through third line forcing. We were able to do this because they produce, let's say 10 million pills they have coming on a container from overseas. I'm being ridiculous now – but for a time they were a dollar or whatever they are. But by the time they bottle them up, the pills would be $5 each with everything else.

They avoid a section in the code they do not actually charge any more than the wholesale price of goods and the wholesale price of services. Also the trainer comes in and, if that trainer is paid $25 plus expenses, that's exactly what the pharmacy pays to have that person in their training their staff. And so company said we're not making a profit on the trainers or the pills.

I don't know if the ACCC accepted that.

Ninty five percent of the time though, we put a clause in the Agreement to say that it's imperative, that's the wrong word, the franchisor requires that the franchisee each get the authorized goods or authorized products from authorized suppliers, etcetera, etcetera, etcetera but, if the franchisee can find that product elsewhere, the product has to have the franchisor's consent which cannot be unreasonably withheld, etcetera.

So what happens in the real world is, I find a product which is the same, it's not all about price, it might be delivery, it might be ingredients. Food is very good to deal with because you can put a burger or something under a microscope and see it's got a lot of different fats and bits and pieces in it whereas the others might look the same but it might not be to the specifications.

So the franchisor then finds a new supplier who the franchisee has found for them, or they in fact get the existing supplier to sharpen a pencil, or make a better product or deliver quicker or whatever it might be. In the real world, it doesn't cause a problem.

There's classic case in Queensland. A tyre place which used to be called Wimps opposite Kmart on the way to Brisbane, I forgot the name of it, just north of Logan. The franchisee used to hop across to Kmart Tyres to get his tires instead of ordering them form the franchisor. The franchisor they took him to court which ruled the franchisee was free to buy his tires wherever they were, because they were of the same specifications and size, etcetera, etcetera and he could buy them cheaper.

So it doesn't very often occur where I'm actually one against one with the largest tire franchisors on the other side. I was acting for a franchisee, who was representing a group of franchisees. We're trying to reach an agreement whereby people can rush off and buy the same tires and which they can buy in Sydney, imported and cheaper, and we're trying to sort of negotiate a settlement rather than end up with the ACCC.

Brian

And that's certainly a place you don't want to be because, as a franchisor, it may well be that the margin you have on those tires is a contingent part, an essential part of your cash flow and the profitability of your business. So it is something to be conscious of.

My thing is that it's always better to disclose any margins or rebates.

Ivan

It's in the disclosure documents, particularly since the first of July last year which is the last amendment of the Franchising Code. Section 9.1, I think – I and J.

Now, it says, does the franchisor or an associate, which means any company, defined as any company, which has a 15% or more common holding with the franchisor or any of its shareholders, does the franchisor and associate receiving any rebates or financial benefit from supply of goods or services to a franchisee.

You've got to put there yes or no, that's quite simple.

The next one used to say how are you going to share, and it still says that, but the one before has now been broadened saying who's it from, so you have to list out who they come from, but you don't have to actually list it as an amount. You just have to say whether it's going to be shared and if so, in part or in whole or whatever.

Most franchisors say something like, yes we will share.

You've got to be careful of these answers but really, it's not a trap if you fully disclose who they're coming from. That's the main thing because I don't know if someone is running around in a BMW on the Gold Coast who is the franchisor of East Paper because his paper supply for the national franchise gives him a new BMW on lease every year so he's now going to disclose that, whereas 15 years or 10 years ago, he didn't have to.

Brian
No, it always creates suspicion and that's the beginning sometimes of spoiling a really good relationship.

INTELLECTUAL PROPERTY LICENSE

Brian
Right, okay and now another item that pops up is an **Intellectual Property License**.

Perhaps you could just expand on that briefly.

Ivan
Yes, well ideally, I mean there's all sorts of things people should be doing in their lives and this is not tied to this discussion in franchising necessarily, but ideally in business, people should separate their assets from the risks. Particularly if it's a husband and wife situation, often when buying a business, forgetting about franchising, one party would own all the assets and the other party would go and buy the business and take all the risks.

So, when we come to franchising, we try and do the same. We counsel our clients to do the same in putting all of the 11 herbs and spices if you like, all of the how to do it, the logos, trademarks, the systems, the software and all that sort of stuff into what's called an intellectual property entity, for a better word and that's usually a company. And that company would be like holding all the jewels in your left hand if you like, then that company looks at your right hand and says, I don't want to use all of the jewels but only use some of them, not own them to go franchising. So that's what an intellectual property license is, it's a license for the intellectual property holder, who holds all that valuable information, customer list, suppliers list, and all that sort of stuff, data bases, call numbers and all that sort of stuff. It actually allows the franchisor to go to market with the [Inaudible 00:21:02] owner.

Brian
Right and then in turn, the franchise, an integral part of the franchise agreement, has his right to acquire the use of that intellectual property as a licensee or franchisee.

Ivan
Yes, 100% right.

As a licensee or franchisee, you quite correctly say, the best practice for a license is to do exactly the same structure. So that if the franchisor or the licensor goes into liquidation or has a class action against that sort of thing, then the assets I mentioned which we broadly call intellectual property, are quarantined if you like and can't be grabbed but the liquidator or whoever it was.

SERVICES

Brian

Now moving on to **Services**, in what sort of detail should one define the services the franchise is providing to the franchisee?

Ivan

Well, we try to keep that fairly generic, so the franchisors in fact with our wording, has a generic appendix at the end. So there might be Appendix A, B, C, and D. but each is specific about any other or further service, which the franchisor notifies the franchisee about in the manual, or by variation of the franchise agreement during the term, which all of that means exactly what it says. Anything they want to add, that they think can be of use so the franchisee can carry on.

Brian

I see, so adding value.

So for example, they say, "Well, we're going to include blinds cleaning…" then that would meet the criteria and they can incorporate.

Ivan

Yes, again, you don't have to. I mean most people, as you implied, would probably get a surprise because they see what we're doing and that's it, but it's a very, very simple method.

People get carried away with how complex things can be or should be, but we just like to say, that's easy. If you're going to have as an offer of service, blinds cleaning, you just change the definition of the franchise business or add an authorized service by way of a very simple two-page variation and off they go.

So the list of authorized services is really just to make sure that they do what they're supposed to be doing and not, for example, selling hamburgers if they've got a carpet franchise or whatever.

Brian

Then you're also going to a little bit of detail in some cases with regards to sales enquiries, or leads from the point of view of whether the franchisor or the franchisee is responsible for them, particularly in a home or a business service delivery franchise for example.

Ivan
Yes, I say to people when they come in and want to talk about franchising. I probably speak to someone in this initial conversation for an hour or two. Probably every fortnight someone new comes in. Some decide not to go ahead and that's fine. We're happy to offer that service usually for an hour or two at no cost to people.

When they ask what do we bring, I say an open mind and I say when I get into the detail, I tell them that the rule is that there's no rules. Obviously it's got to comply legally, but it's the same with customer call centres rather, lead generation and all that sort of thing. It's what the franchisor thinks is fair and reasonable after considering what will also recompense the franchisor for lead enquiries and costs and how it all works.

We have one franchisor who allows 20 leads a week at no cost. They are after the people who pay them. Some people run a 1-800 number and just carry the cost and put it out in a geographic method or 1-300 in way that works.

So it's all just a matter of what the franchisor considers will work.

We're just doing work for a client who went on to broker a public company. Basically it's a service type industry in which you have to respond to the customer within 24 hours of the first inquiry and then within 72 hours, you have to do this, and then within the 7 days, you need to have it delivered and install the product, if the person wants it.

So those are just timelines within which they require the services to be offered.

Brian
So a fairly strict performance criteria.

Ivan
Well they are, but they're to keep people going, otherwise you will see people being lazy and when their phone rings they say, "We won't answer that, we're too damn busy…"

So this sort of service criteria make sure that people have fall back positions, if people are too busy, they can then go to the franchisee next door and ask him to assist and that sort of thing.

Brian
License-like the performance criteria, are fairly critical from the point of view of the franchisee and the franchise agreement because if a franchisee doesn't comply with these, he's running the risk of a serious infringement, isn't he?

Ivan
Yes. We do normally look at the customer response thing differently from the minimum performance criteria, but you're quite right, minimum performance criteria is now recognized in the Code as being a valid requirement of franchisors and that usually relates to, not always, but it usually relates to gross income of the franchise business. So very often, people don't have to meet the requirements in the first three months or something, but thereafter they're supposed to have achieved a certain number of sales or a certain value of sales.

In plain terms, say in a shop, once a month, they've got to do $ 10,000 gross income or whatever. But as I say to franchisors and to franchisees, it's a very brave franchisor that would enforce minimum performance criteria or the franchisee is out. Most people would bend over backwards. Most franchisors, and most franchisors are good franchisors, realize that sometimes markets are good and sometimes they're bad, so they would try and help the franchisee. But there also are some franchisees who just don't want to help, just don't want to be helped. They just get negative about their business as they would if they owned the business. They don't get negative just because it's a franchisor. Or if they need to get negative it will happen a hell of a lot later in the franchise than they would in a normal stand-alone business.

A minimum performance criterion is important. It needs to be thought out. It needs to be enough of a goal to keep the franchisee going, but not so much that they lie awake at night and say we're not going to reach the minimum performance criteria. That's why it needs to be averaged over a number of months or a fairly long period and not just one bad week or two or four bad weeks in every two months or something.

FRANCHISE FEES

Brian
A question a lot of people ask me is, is there an already predetermined franchise fee. But of course the franchise fee is whatever you choose to make it. From a commercial business point of view, any comments from that point of view, from your side of the fence?

Ivan
Yes, well yes and no. It's a question which quite correctly is very often asked. There have even been books written on it.

I sort of look at it very roughly, perhaps in 60 seconds, and say the proposed franchisee will be a mum and dad operation. You look at the working ways, the average ways, for people who, let's say are semi-skilled to unskilled and work out they might expect to be paid, if they were working 40 hours a week, $60,000, or $70,000 or $ 80,000, or somewhere between the two – I'm not sure really, not wanting to be misinterpreted.

So you'd look to see if they would have that type of money and then, once you have an idea of the money they're putting in, you look at that as risk money, money that they'd probably get 20% on if they lent it to a person and they think they may lose it.

You sort of add those bits and pieces up and see how long it's going to take the franchisee to get their income back.

Most franchisors look at getting your franchise fee back within one or two years, so there aren't too many franchises that hit the field running for less than about $ 30 or $40,000 for a one person washing a dog type of thing. And remember, the biggest dog washer in Australia operated for 14 years until they sold for many millions, having grown from one dog wash to 170. This dog wash franchise worked fees out on those types of criteria, so they were charging about $35,000 plus the trailer, plus training at about $50K and people could expect to earn about $40K to $45,000 gross each year.

The fees weren't a large amount, they'd probably be more these days. They sold out in 2005.

So it's very, very hard but some people say, "Well, we'll charge a lesser amount." My answer to that is if you're charging a lesser amount, you're probably going to go broke. You've got to charge enough as a franchisor, not only to cover your cost, but to make profit because being a franchisor is hard work until you get the numbers up.

But you can't, as a franchisor, go straight to the market just to have a million dollars or something as well, because if it is blue sky you are after, remember that's only going to happen when you have some runs on the board.

Brian
Exactly. Look, I think it's critically important. You've got to look at who your

competition is because at the end of the day, it's just like selling. It's no different to a retail business selling a product. It's got to be compared. People shop around. It's just like selling a television set really.

Ivan
Exactly. I think really I agree 100%. But I think the other thing is really to look at what the projected return is. Think of it from the point of view of being in business, so if you've had the business for a year, two, or three, you would know that. I'm saying any person here, or a potential franchisor, not too many franchisors just suddenly wake up and go to the market. There is the odd one or two, but most people thinking about franchising have had a business or have been in the business or something for a few years, so they know what the overheads are, they know where the markets are, they know how much they're expecting to net after or before wages and so on. And sothey can sort of adjust those figures.

So as I said before, the person should be expected to earn, to get a return on their money, and also get a wage. If they're expected to do that, then you can almost charge that first year's income on the basis that if it is $60K or $70,000 less expenses, you might charge $40K or $50,000 to get into a one, or one and a half person business, plus the training, plus any equipment or whatever that might be included.

SERVICE FEES

Brian
Okay, I appreciate that. Look, there are other items but they're not really for discussion now because they tend to be very much a decision that's commercial and are calculated as much as by one's spreadsheets with budgets and reference to your accounts and so on.

These are things like **Renewal Fees** (which we have already covered), but you should be aware of the fact that there is the opportunity to charge fees.

Similarly with the **Transfer Fee**, now that's another one that a lot of people are not conscious of and they have become fairly common these days, but they used to be quite unusual going back a decade or two ago.

Then others such as **Training Costs** and so forth, are also areas where one needs to do a bit of homework to make sure that you're getting the value from the sale of your franchise, and your ongoing revenue opportunities.

Ivan
Yes, particularly with **Training**.

I put training as part of what people should be getting for their franchise fee not added in so it ends up affecting the bottom line.

Franchisees should get training for nothing.

Secondly, they should get it on-going. That should also basically be for nothing because that's what the service fee is for, although some people call it the royalty.

But we do have an additional training fee which is not very often used, but it's really just when a franchisee wakes up and doesn't know how to turn on the computer or which side to put his shirt on and he keeps on ringing me up to find out. Well then the franchisor can say, well we're now going to give a day's training to teach these things. It's going to cost you X dollars.

So, you're quite right. **Service Fees** have always been there.

Renewal Fees certainly have been very common in the last 10 years. Every franchise now has a renewal fee. I suppose there are some who don't want to charge it but that's very, very unusual.

A **Transfer Fee** quite right, when the franchisee decides to sell, he has to have the franchisor's consent. Like the old 'key money' which is illegal now, with the landlords but it's not a fee. And that's what I say to people, the rule is there's no rules. There's nothing to say that you have to have these fees. There's nothing to say that it can't be an absolutely outrageous charge unless of course the franchisee your franchisee.

So all of those things are flexible and a lot of people now are adding service fees.

If they're fixed, they make them go up 5% a year or CPI in the recent cases that I've mentioned. About six or seven years ago, where a company wanted to put up their service fees by CPI and, they did it and the franchisees took them to court. The court held that that was quite reasonable for the franchisor to do that, even if that wasn't in the franchise agreement. So it's understood that fixed fees, particularly, should grow, percentage fees should grow of course because if you're paying 5% of a thousand and the next year you're paying? You're earning 2000, you pay 5% so that the franchisor gets the increased benefit but you've earned more money.

Brian
Yes, and as always with CPI increases, there's always the risk there because periods of high inflation, and periods of low inflation, will reflect accordingly

but that at least means there's one measurable way of doing it. Alright, what I'd like to do is thank you very much for that exhaustive summary Ivan. I'll ask if you could give a summary of the documents you provide for a prospective franchisor.

MARKETING FEES

Brian

Right. Okay, let's just go quickly through one of the other key areas. The **Marketing Fees** which are defined quite clearly under the Code as are the requirements for auditing them and so forth.

What's your view on those, Ivan?

Ivan

Well, marketing is always a bit of a problem. Particularly as you're talking mostly here about start up franchises. Most franchisors don't start up a marketing fund until they've got a number of franchisees, let's say five or 10 or something like that. Otherwise, if I'm the first franchisee and Brian doesn't come along, it's the second for four years I'm contributing and the amount will be so small that it won't be much use to build up, then everyone else will get the benefit. That's just general common sense.

But most franchisors require, depending on the franchise and we're talking here perhaps the middle of the road stuff, not like McDonald's, Subways and so on, they require normally the franchisee to spend an amount in local area marketing for the first start.

Outback Jack's is a chain we look after; they've got about 26 restaurants and have been going about four years, but when they started, they had a local area marketing budget of 2%, or it might have been 3%. Today they still have to give 2% but an additional 2% also goes into the national marketing fund. They introduced that marketing fund, which is subject as you said, to the provisions of the Code as to auditing and handling and so on.

That's how franchisors manage the fund as they grow to the stage where they need a national fund. And finally they might cut out the local area marketing all together eventually.

Coffee for example did that, up to about 20 outlets they had local, and ordinary marketing, and now they're focusing on marketing based on gross income and the marketing which the franchisor looks after, and 1% is for promotional products and things either in or outside the stores.

RENEWAL TERMS

Brian
Right. Terms, **Renewal Terms** are a point of interest and there's been a little bit of discussion about these in recent years with regards to West Australia and [Inaudible 00:42:40] and that sort of thing.

But Renewal Terms need to be clearly specified, don't they?

Ivan
Yes. Look, my attitude to that is that why not give the franchisees as long as you like because bluntly, most franchisors will want to turn to their franchise over, whether it's one year, five years, 10 years, or 20 years after they've actually started. But a lifetime for a franchisor is very often between five and 10 years. I've got a franchisor coming at 2 o'clock that I mentioned before to discuss things like this. They've just bought another chain, with five years plus five years and I thought, why not give it to these people because you want to sell them some high fees, give them another 15 years instead of five years. They then see the ability to build the business up and pass it on with some good time left, or good value in time left, to a new franchisee who becomes purchaser. It also doesn't do the franchisor any harm when they come to sell as well, because they could say to the buying franchisor or new franchisor, look, we've got 50 out there and they've got between five years and 15 years to run with their renewals rather than sort of count them down so many months and so many years.

RESTRAINI NON-COMPETITIVE CLAUSE,

Brian
Exactly.

Now, I have come across a misunderstanding as to how tightly you can enforce the sort of **Restrain Non-Competitive Clause**, when a franchisee leaves your organization and sets up in competition. Now there are scaled restraint periods that are generally set. Can you just mention the sort of the process behind that or the reason for that?

Ivan
Yes. What you're talking about is called *Cascading Clauses* and they're just like that, they're like a waterfall. So for example, for a territory area, it might say the franchisee can't work in that territory after it's terminated. Or the territory of any other franchisee five kilometres outside of that territory or 50 kilometres outside of your territory or the whole of the state just for example. It might also give a period say, something like six months, one year, two years, five years and so on.

That is there for the legal reason, which we won't go into quite some much detail, basically it allows the court, if there's an argument, to say that Brian as the franchisor had told Ivan as the franchisee, the period has to be five years and the whole of the country by choosing those cascading lines.

Whereas we're prepared to say it can be the whole of a country but only three months or five years and just within the territory. So in other words, it gives the court the ability to manipulate. There was a case about 20 years ago when the courts said we'd love to help you but we can't. There isn't the option in the agreement.

And, I know quite a lot about restraint because we're always either enforcing it or arguing it with people and even sometimes in court.

In practical terms, which is far more important, the basic rule in one sentence is the law in Australia and, generally I used to practice in Asia, the law generally, will not stop a person, we're talking about one person, a person carrying on what they've been trained for, whether they learned that training by way of an apprenticeship or something more formal or whether they learned it by way of being a franchisee.

So if you learned to cook burgers as a Mc Donald's franchise manager let's say or owner or for five years as the franchisee, and you learned that then they can't stop you going right next door and doing the same thing. But it can stop you obviously from calling yourself Mc Donald's and having Donald Mc Cloud or whatever it is. I'm being stupid, because it's actually intellectual property, but it can't stop you from using your skills which franchisors often jump up and down about, but it's as simple as that.

Really that is what people like to argue and spend lots of money on with restraints, and lawyers give a mix of very fudgy answers often to benefit their own fee structure, but it's as simple as that.

We did quite a lot of de-badging, I'm somewhat of an expert on that, and that is when franchisees come to us and say we want to carry on the same business, even in the same territory, how can we do it? And it can be done and we've been doing that for more than 20 years. We de-badged nine outlets in the one chain out of 15 about seven years ago over about a year. I'm pretty popular with the franchisor but never mind, and it's just a matter of being able to do it but it was a move away from everything that that franchisor did by adding extra services which you mentioned. It was a man in a van operation, had different types of colour schemes, added extra territories, added extra products, and added different uniforms. You can imagine all the changes that have to be made and then the person basically goes in one door a certain colour and comes out the other a different one, almost.

So, the short answer is the restraints can be enforced, but they can only be enforced when the franchisee is using your intellectual property.

Brian

That's why I appreciate your contribution and your knowledge Ivan, because these sort of case studies help enormously when you're trying to frame up the protection of a new franchisor. Because being aware of those types of things means you can plug the gap before it occurs in many respects.

Ivan

Yes, you can do it. We have just spent quite a long time with a new franchisor, two or three hours I suppose which seems a lot of time, in actually making a restraint business definition for their new business. Which is why we just make it a franchise business and then it looks like it. This is a business consulting business and quite successful in two or three countries, and it's based here in Australia, we were given the job of re-writing all the documents on how to do their work, over the last few months.

So we sat down and thought of all the little nuts and bolts that actually make up their business. It's really very, very tight now and people can't just say, well we're doing this because it's a different business.

Documents provided by Ivan Poole Lawyers for a Franchise System

Ivan

Yes, well what we provide as a firm, and I have to be careful not to make it so specific that you think that is all legal documents we generally do, but the most important documents for a franchise.

Let's leave licensing for a moment, we can cover that in a minute if we have to.

One of the documents is the **Disclosure Document**, which is a document which is required from the code and if anybody wants to get a copy of the code, you can simply go to Trade Practices Industry Code Regulations and you'll get the code and in the back of that, you'll see a sample of one. So the disclosure document is just one. It runs to I think 22 points, some of them with numerous subheadings and subsections. So what we have to do is use every question there, exactly as it is and give an answer and my 10 seconds summation of the disclosure document is that it's a waltz and all if you like. Look at what the franchise is about, who's behind it, have they been to jail, have they been good people, what will they provide, and all that sort of thing. So it's a history, a working history of the directors and people involved in the franchise and all that sort of stuff, so that you can sit in front of the fire and easily read it. It's supposed to be like that. It's supposed to give you a thumbnail sketch if you like. It's small but it's supposed to give you a full look at the franchise.

So for example, it has in there in Section 6 which is very important, who are all the current franchisees, what are their phone numbers, what's the business they have, what's the name of the franchise and the reason for that is so prospective franchisees can call existing franchisees. It then has a section covering the last three years, for about seven or eight different things, sort of principally who has been axed, sacked, left and so on, not renewed.

The full details must be put in there, including why they actually did those things, especially if it wasn't renewed and so on. And again, phone numbers and things can be provided. We won't go into that in too much detail but they're provided, they have to be provided unless the exiting franchisees says they don't want to be contacted. So it gives all that sort of thing, so that's a major document, the disclosure document.

The other major document, the two, long bulky documents out of a **Franchise Agreement** and certainly what we do here.

Just quickly, we're here to sell a suite of documents that are fixed price or price to be negotiated, and we start off with everything.

We start off with some structuring advice to make sure the right entity holds the intellectual property, the right entity is going to be franchising, that the franchisor and the directors are protected or the intellectual property is protected from valid court claims or even bankruptcy or liquidation, so that it can still all be used. I had a few of those, where the intellectual property floats away and is reused, again it's still there, the brands, the logos, the methods and so on.

Then we go through a series of confidentiality agreements for day to day use, dealing with intellectual property transfer, intellectual property license and a few things like that.

So we tend to end up with 20 documents admittedly, a few of those are one pages or a few of those have four or five, or six pages and a couple of those are 10 to 12pages.

The big ones, the Disclosure Documents and the Franchisee Agreements, can easily end up huge. Disclosure Documents are usually about 40 pages and in the Disclosure Document you've also got to put in the ACCC franchisees manual now, and financials for two years of trading and a copy of the code, so it becomes a very bulky document. The actual Disclosure Document, as opposed to a single license, which might be 20, 25 pages. Needless to say, one's like a medium and one's like a requirement. You just have to put up with that paperwork if you're going to go into franchising.

Brian
Yes, so it's increased, hasn't it? The requirements for disclosure and so forth have incrementally sort of increased over the years, the franchise code has been in existence.

Ivan
Yes, it has and actually, look I say to people all the time, if you've got nothing to hide, there's no reason why you shouldn't disclose and be a franchisor. Occasionally we would even probably have a person who's unfortunately gone bankrupt and been out of it for the last 10 years, they've got to disclose that. We've got a very successful franchisor, who went bankrupt five years ago in a property deal. He's renowned as a franchise and he's got a new one now, he's got about 4 franchises in two years on the internet and it's going exceptionally well, but you know we have to disclose that, so we just use the correct wording to say what happened to him but it doesn't affect his ability to be a good businessman, it wasn't dishonesty. But it is really meant as I said, for potential franchisees to have a good look at things, see who's in there, how many have dropped off in the last three years, which is always good indication in proportion to the current number they had and that sort of thing.

INSURANCES

Brian
Another area people tend to overlook until it is brought to their attention, is the need to specify quite carefully the **Insurances** that a franchisee needs to have.

Ivan
Yes. Well, I mean the best franchisors do go into that in some detail during the two or three months we work with them to setup a franchise (which might be 20 hours talking with a franchisor at various stages and doing documents and reviewing and so on). But you're quite right in that the good franchisors do research what the franchisor and the franchisee need by way of insurances, licenses, permits; all that sort of thing. And they don't just say, 'We'll go off and see an insurance broker and run down to the council and knock on the door and say I'm running a dog wash, what do I have to have,'

and so on.

So insurance, you're quite right, is important. The franchisor needs to know what the insurance risks might be and the bigger insurance needed, which happens with the bigger franchisors as you're aware, may well mean the franchisors have an arrangement with a franchise company for, what I might call, a global policy for all their franchisees. Which means three things – one, it's easier to get the insurance because the company already knows all about the business, two, they can easily make a claim and three, premiums are usually lower.

Brian

And it's critically important here for a franchisor to ensure these covers are effective, because there are areas which are a bit grey, perhaps when you look at public liability and other company requirements. In the event there is an issue and the franchisee is not covered, there can be cases where it can be quite difficult for the franchisor.

Ivan

Yes, the Code actually foresaw this in one of its more enlightened moments, and one of the franchisors' (what I call the seven deadly sins,) are seven automatic rights to terminate a franchise, and I mean terminating immediately within minutes of being handed it (it's not a remedial or remediable) is, in fact, not holding the necessary license or permit or authority to carry on the business. But it includes insurance.

It goes back to that other stage of things that I said, the license or the permits, are seen as being so serious by the government, the watch dogs, that it's immediately actionable against the franchisee and they can lose their whole business.

CONCLUDING REMARKS

Brian

It is because these are the issues, which you really need to be sure you address, so that in the future, when that franchise agreement is away in the filing cabinet, if ever there's any need for recourse to it. Because if there are any questions raised, you've got it there and you feel comfortable and you sleep well at night knowing that you got the issue covered and you're not likely to be vulnerable. What I'd like to do now Ivan, if you've got a couple of minutes, is just to see if anyone has any questions. If anyone would like to ask any questions, it's an open gambit and all you need to do is just hit *6, that will un-mute your line and you can ask any questions of Ivan or myself. Let's give people a moment or two if they've got anything written down or whatever.

Otherwise, you're very welcome to drop an email through. Ivan and I spend some time talking in the course of business so you're welcome to send an email through to me and if appropriate, I'll forward it through to Ivan or we'll give you a response, whatever is needed. But in proceeding through in preparation of your system, know that at some stage you'll be in touch with Ivan in any event, as our preferred and recommended supplier from the point of view of franchise agreements and I think you'll take the benefit of a lot of advice and a lot of knowledge.

Ivan
Well thank you for the opportunity Brian and all the listeners here today.

Brian
And thank you everyone for joining in. We'll catch again at our next Radio Show to our members and Ivan, we'll speak again sometime down the track.

Ivan
Thanks for the opportunity. Thank you very much Brian.

Brian
Thank you, I really appreciate it. Bye!

CONCLUSION

In Australia, much governing the way a franchise is structured and managed is legislated.

This starts with the four point test which determines the difference between a licence and a franchise.

If your business meets the criteria set out in the test then in will be a franchise, whatever you decide to call it and then the bones of the relationship between the franchisee and the franchisor will be set out in the Franchise Agreement.

A Franchise Agreement can be very simple or it can be complex, depending on the requirements of your business. It pays, however, to understand the full list of things which can be included in the document before it is drawn up.

The Agreement can form the basis for a fair and good working relationship because if drawn up well, it provides a transparent and equitable way to move forward.

Hopefully, this interview has given you a deeper level of insight into some of the research and homework required when you're setting up your own franchise.

Good luck with your franchising endeavours!

THE PARTICIPANTS

The Interviewer

Brian Keen from 'Franchise Simply'

Brian Keen has worked in the franchise sector for over 30 years and believes franchising offers one of the most exciting business models around for anyone looking to share their success and create real wealth and financial independence for themselves.

He first saw the massive potential for franchising to create a successful business – fast – after opening and operating seven stores in just five years as a franchisee for Bedshed.

With the knowledge gained there, he went on to set up Franchise Alliance, a consultancy which helped household names like Brumby's, Ultratune, Jim's Mowing and Donut King develop successful sales strategies and franchise systems. The Franchise Alliance expanded with offices across Australia and New Zealand and is still going strong within six capital city offices.

During this time Brian and his partners used their knowledge to build up six franchise groups of their own with over 120 outlets between them.

They visited Europe and the US a number of times negotiating the import of franchise systems into Australia as well as expanding some of their own franchise groups into South-East Asia and elsewhere.

Based on this depth of experience, has helped many dozens of businesses to franchise successfully, increasing their profits and allowing their owners to retake control of their lives by working fewer hours.

He has now brought all his knowledge together in his latest venture, How to Franchise Simply, with the aim of showing business owners how to transform a family-sized firm into a multi-million dollar asset through a unique four-step system, saving tens of thousands of dollars in consultancy fees in the process.

Brian is passionate about helping people become financially secure and independently wealthy by setting up their own business, wherever they are, whatever their background. That's why he also founded and became Chairman of MicroLoan Foundation Australia (MLFA), a charity which, to date, has provided over $750,000 in loans to impoverished women in Malawi to allow them to start their own business and improve life for themselves and those who depend on them.

Originally from Uxbridge, UK, after practising as a quantity surveyor, Brian emigrated to Malawi in 1966, where he established several successful businesses, most notably a building and development company, before moving to Perth, Australia, in 1975.

Brian has 40 years' experience in Australia and internationally as a business owner and company director, primarily focusing on business growth, particularly sales and marketing in the franchising industry.

Brian Keen
www.briankeen.com.au and **www.franchisesimply.com.au.**

Being Interviewed

Ivan Poole from Ivan Poole Lawyers

Ivan Poole has specialised in Franchising since he arrived in Australia in 1980 after practicing in New Zealand and Hong Kong. He began the specialty in 1987 – when he then acted for two Franchisees – and the firm of which he was a partner commenced a Franchising and Intellectual Property Division. He has since that time acted for hundreds of both Franchisors and Franchisees in creating documents and the continuous development of legal documentation for Franchisors and for Franchisees, principally in sales, purchases and disputes.

Ivan Poole Lawyers now consists of three dedicated specialists and works from a high tech office in Southport, Gold Coast with Clients across Australasia. The firm also represents a number of overseas Franchisors in their Australian operations as well as Franchisors who have gone offshore. The focus of Ivan Poole Lawyers is entirely franchising and Intellectual Property, Franchising taking 90% of the workload.

Ivan Pool has written for magazines, tutored in Franchising at Bond University for 10 years and has amongst other public presentations of his Franchise knowledge, been involved with Brian Keen of How to Franchise Simply since 2009. Ivan Poole understands Franchising in its most intimate detail and has over the last 30 years built up excellent commercial knowledge in Franchising as well as a full and complete understanding of the Legislation particularly as it relates to compliance issues.

ONE LAST THING

I write books about franchising and I am involved with my business, *Franchise Simply* and charity, *MicroLoan Foundation Australia* which gives business loans to impoverished women in Africa to set up their own businesses.

To find out where the other books are in the writing and publishing process and to find out about my business and philanthropic enterprises go to www.briankeen.com.au

And if you particularly enjoyed this interview, I'd be eternally grateful if you posted a review and passed it on to friends and colleagues who may benefit from sharing this invaluable knowledge about the exciting world of franchising.

Thank you so much for reading my books.

All the best

Brian