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## **GLOSSARY OF FRANCHISE TERMS**

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**© 2011 Keith J. Kanouse  
One Boca Place, Suite 324 Atrium  
2255 Glades Road  
Boca Raton, Florida 33431  
Telephone: (561) 451-8090  
Fax: (561) 451-8089  
E-mail: Keith@Kanouse.com**

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## **GLOSSARY OF FRANCHISE TERMS**

Franchise Disclosure Documents (FDDs) and franchise agreements contain many unique words and phrases readily understood by franchisors, franchise brokers and franchise attorneys. However, these words and phrases may not be part of the typical person's vocabulary. The following is a brief explanation of commonly used words and phrases (in alphabetical order) contained in FDDs and franchise agreements.

**ADI**" usually means an Area of Dominant Influence, which is a geographic survey area created and defined by Arbitron based on measurable patterns of television viewing consisting of all counties in which the local station receives a preponderance of total viewing hours.

**Advertising Contributions**" usually means the payments made by a franchisee to the franchisor which are deposited into a regional or national marketing fund for regional and national advertising on behalf of all franchisees.

**Advertising Cooperative**" usually means a group of franchise outlets and company-owned outlets of a franchise system who contribute money to engage in local or regional advertising on behalf of the group.

**Advisory Council**" usually means a franchise advisory council created by (and sometimes controlled by) the franchisor to give advice in advertising, operations, new products and services, etc. The franchisor is usually free to accept or reject this advice.

**Affiliate**" usually means a person (other than a natural person) controlled by, controlling or under common control with the franchisor, which is offering franchises in any line of business or is providing products or services to the franchisees of the franchisor.

**Agent**" usually means a person authorized to act on another's (principal's) behalf

**Agreement Date**" or **Execution Date**" usually means the date on which the franchise agreement was signed.

**Approved Supplier**" usually means a third party (which may be the franchisor or affiliated with the franchisor) from whom the franchisee may, or is required to, purchase supplies, equipment, ingredients, or other goods or services for use in the operation of the franchise business.

**APR**" or **Annual Percentage Rate**" usually means the rate of interest charged (after excluding prepaid interest, points and certain other expenses paid out of the loan proceeds) or computed under the Consumer Credit Protection Credit Act, 15 U.S.C. §§ 106-107. The APR is usually slightly higher than the actual interest rate charged.

**Arbitration**" usually means a non-judicial resolution of a dispute made by one or three individuals called arbitrators. The arbitrator's decision is usually final and binding on the parties and not appealable.

**Area Developer**" or **Developer**" usually means a person who has the right to open and operate 2 or more franchise businesses within a specific area. He or she is really a multi-outlet franchisee. (See Part F below).

**Area Representative** or **Development Agent** usually means a person who sells franchises and services and supports these franchisees on behalf of a franchisor.

**Assignment** usually means the transfer of the franchisee's interest in the franchise agreement to another person who becomes the franchisee under the franchise agreement.

**Business Day** usually means a day other than Saturday, Sunday or a U.S. national holiday.

**Business Format Franchise** or **Package Franchise** usually means the situation where the franchisee uses the franchisor's system of doing business rather than by buying from the franchisor. (for example, a restaurant franchise).

**Camera-Ready Advertising** usually means art work and typeset materials which are ready for printing.

**Company-owned Outlet** usually means a business the same as the franchise business you are considering buying but owned and operated by the franchisor or any of its affiliates.

**Competitive Business** usually means a business which is engaged, wholly or partially, directly or indirectly, in competition with the franchisor and its franchisees.

**Confidential Information** usually means all information, knowledge, know-how and technologies that the franchisor designates as confidential, proprietary or trade secrets. Confidential information can include, among other things, the franchisor's manuals, secret recipe products, private label products and software.

**Consumer Price Index** usually means the Consumer Price Index published by the U.S. Department of Labor which measures inflation.

**Conversion Franchise** usually means converting an existing, operating independent business to a franchise outlet of a franchise system.

**Cooperative** usually means the regional advertising cooperative created by the franchisor composed of franchisee outlets and company-owned outlets in an ADI to engage in collective advertising.

**Copyright** usually means the right of the author to use exclusively any literary or artistic production.

**DMA** usually means a designated marketing area where television stations broadcast created by A.C. Nielsen Company. Similar to ADI.

**Earnings Claim** usually means representations about the actual or potential sales, income, or profits of existing or prospective franchisees. It is now referred to as a Financial Performance Representation or FPR. If the franchisor makes an FPR, it must be included in ITEM 19 of the FDD.

**Estoppel Certificate** usually means a statement by the franchisee or the franchisor to a third party (such as a prospective buyer) about the status of the franchise agreement.

**Event of Default**" usually means a default which still exists after the giving of any required notice of default and the expiration of all applicable time (grace) periods in which to cure the default and, thereby, entitling the franchisor to, possibly among other things, terminate the franchise agreement.

**Exclusive Territory**" or "**Protected Territory**" usually means an area around the franchise business usually described as a radius (for example, 3-mile radius) or by street, or population (for example, 30,000 people) in which the franchisor agrees not to open a company-owned outlet or issue a franchise to another person.

"**FDD**" or "**UFDD**" usually means the franchisor's current Franchise Disclosure Document and all its exhibits and supplements.

**Force Majeure**" is a French term meaning superior or irresistible force. It usually means acts beyond the control of the parties such as earthquakes, floods, hurricanes, tornadoes, and other act of God.

**Franchise**" usually means the rights granted to the franchisee under the franchise agreement. Under the FTC Franchise Rule a franchise is composed of 3 elements: (1) license of a name and/or logo or "substantial association" with trademark; (2) payment of initial and/or ongoing franchise or royalty fees (at least \$500 on or before the first 6 months of operation, exclusive of the wholesale price of a reasonable amount of inventory); and (3) significant assistance to, or control over, the franchisee's method of operation. Sellers of vending machines and rack displays are also considered franchises (business opportunity ventures) if the seller provides accounts or site location assistance or another person to do so.

**Franchise Advisory Council**" usually means a group formed by, and possibly controlled by, the franchisor for the franchisees to give input to the franchisor on various issues such as advertising and operations.

**Franchise Broker**" or "**Franchise Salesperson**" usually means any person other than a franchisor or a franchisee who sells, offers for sale, or arranges for the sale of a franchise on behalf of the franchisor or a subfranchisor and receives a commission from the franchisor or subfranchisor.

**Franchised Business**" usually means the business the franchisee is authorized to establish and operate pursuant to the franchise agreement.

**Franchise Owner**" usually means: if the franchisee is an individual, that individual; if the franchisee is a corporation, the individual who owns a majority of the voting and ownership interests in the corporation; if the franchisee is a partnership, each individual who is, or owns a majority of the voting and ownership interests in an entity that is a general partner of the partnership; and if the franchisee is a limited liability company, the individual who owns the majority of the membership interests in the company.

**Franchise System**" or "**System**" usually means the franchisor's system for operating its concept, which system includes specific standards and procedures and proprietary property.

"**Franchises Outlet**" usually means a franchised business owned and operated under the system by a franchisee.

**"Franchisee"** usually means all persons signing the signature page of the franchise agreement as franchisee, jointly and individually.

**"Franchise Association"** usually means an association, independent of the franchisor, formed to represent solely the interests of the franchisees in a franchise system.

**"Generally Accepted Accounting Principles"** usually means those standards, conventions and rules accountants follow in recording and summarizing transactions, and in the preparation of financial statements. Generally accepted accounting principles derive, in order of importance, from: (i) issuances from an authoritative body designated by the American Institute of Certified Public Accountants ("AICPA") Council; (ii) other AICPA issuances including AICPA Industry Guides; (iii) industry practice; and (iv) accounting literature in the form of books and articles.

**"Grand Opening Advertising Fee"** usually means the fee paid by the franchisee to the franchisor to be expended for special grand opening advertising activities when the franchise business first opens for business.

**"Gross Revenues"** or **"Gross Sales"** usually means the entire amount of all revenues of the franchisee arising out of the ownership or operation of the franchise business or any business at or about the premises including the proceeds of any business interruption insurance and any revenues received from the lease or sublease of a portion of the premises, whether the revenues are evidenced by cash, credit, checks, gift certificates, scrip, food stamps, coupons and premiums (unless exempted by the franchisor), services, property or other means of exchange, excepting only the amount of any sales taxes that are collected and paid to the taxing authority. Cash refunded and credit given to customers and receivables uncollectible from customers will usually be deducted in computing gross revenues to the extent that the cash, credit or receivables represent amounts previously included in gross revenues on which royalty fees and advertising contributions were paid. Gross revenues are usually deemed received by the franchisee at the time the goods, products, merchandise or services from which they derive are delivered or rendered or at the time the relevant sale takes place, whichever occurs first. Gross revenues consisting of property or services (for example, "bartering" or "trade outs") are usually valued at the prices applicable, at the time the gross revenues are received, to the products or services exchanged for the gross revenues.

**"Guarantee"** usually means the written promise of a person to be responsible for the obligations of another. In franchising, it usually means the promise by a person other than the franchisee (for example, a shareholder) to be responsible for the monetary and other obligations under the franchise agreement of the franchisee (for example, a corporate franchisee) to the franchisor.

**"Indemnification"** usually means a promise by one party to restore another party of a loss by payment of money, replacement or repair.

**"Initial Franchise Fee"** usually means the fee paid by the franchisee at the time the franchise agreement is signed in payment of the license of the trade name, use of the manuals and the system and the initial training or other services rendered by the franchisor to get you up and running.

**"Late Charge"** usually means a charge imposed by the franchisor if the franchisee pays royalties or other payments late.

**"Liquidated Damages"** usually means an agreement between parties that one party will pay to the other party a fixed dollar amount as damages for the parties breach instead of the non-breaching party having to sue and prove actual damages.

**"Local Advertising"** usually means advertising and promotion undertaken by the franchisee in media directed primarily in the franchisee's local market area including television, radio, newspapers, magazines, billboards, posters, handbills, direct mail, yellow pages, sports program booklet advertising, church bulletins, collateral promotional and novelty items (for example, matchbooks, pens and pencils, bumper stickers, calendars) that prominently display the franchisor's proprietary marks, advertising on public vehicles including cabs and buses, the cost of producing materials necessary to participate in these media and agency commissions on the production of the advertising and amounts paid to an approved regional advertising cooperative or to a merchant's association for advertising of which the franchisee is a member. Local advertising usually does not include payments to the marketing fund for regional or national advertising nor payments for permanent on-premises signs, lighting, purchasing or maintaining vehicles even though the vehicles display in some manner the franchisor's proprietary marks (except the cost of the materials displayed are included), contributions, sponsorships (unless the franchisor's proprietary marks are prominently displayed by the group or activity receiving the contribution or sponsorship), premium or similar offers including discounts, price reductions, special offers, free offers and sweepstake offers (except that the media costs associated with promoting the premium offers are included), employee incentive programs and other similar payments that the franchisor may determine in its sole discretion should not be included in determining whether the franchisee has met his or her obligation for local advertising.

**"MSA"** usually means a metropolitan statistical area that is a population area with a population center and adjacent areas having a large degree of economic and social interaction with the center.

**"Manager"** usually means the person primarily responsible for the day-to-day operation of the franchise business.

**"Manuals"** usually means all manuals produced by, or for the benefit of, the franchisor and loaned to the franchisee, now existing or later produced, and any revisions prepared for the internal use of the franchise business such as an operations manual, training manual, sales and marketing manual, etc.

**"Marketing Fund"** or **"Advertising Fund"** usually means a separate fund controlled by the franchisor into which advertising contributions are deposited for use in regional and national marketing activities to promote the franchise system.

**"Master Franchisee"** usually means a person who has the exclusive rights in an area to sell franchises as a subfranchisor and can also own and operate its own franchises as an area developer.

**"Mediation"** usually means an alternate dispute resolution method where an independent, unbiased person (mediator) meets with the disputing parties to assist in attempting to settle the dispute. Mediation is usually not binding.

**"Multi-Concept Franchisee"** usually means a franchisee who owns and operates franchise outlets in two or more franchise systems (usually non-competing).

**"National Accounts"** usually means a customer having multiple offices or locations in more than one area. A franchisor usually reserves the right to deal directly and exclusively with national accounts.

**Offering Fee** usually means the fee paid by the franchisee to the franchisor for its review and approval of the franchisee's offering materials used to raise investment capital usually either in a private placement offering or an initial public offering.

**Opening Date**" usually means: (i) the date on which the franchise business is first opened for business to the general public after being newly constructed; (ii) the date on which the franchise business is first opened for business to the general public as the franchise business after being converted to the franchise business from another concept where the operation was shut down during the conversion period; or (iii) the agreement date where the existing operation is being converted to the franchise business without the operation being shut down, whichever is applicable.

**Option Fee**" or **Renewal Fee**" usually means the fee paid by the franchisee to the franchisor to renew the franchise agreement.

**P.O.S. System**" usually means the computerized cash registers, software, printer and modem or other computer hardware required to be purchased by the franchisee in accordance with the franchisor's specifications.

**Payment System**" usually means the automatic payment system created by the franchisee to pay royalties, advertising contributions and other amounts owed to the franchisor such as special checks or electronic funds transfer.

**Predecessor**" usually means a person from whom the franchisor acquired directly or indirectly the major portion of the franchisor's assets.

**Person**" usually means any individual, group, association, limited or general partnership, corporation, or any other business entity.

**Personal Meeting**" usually means a face-to-face meeting between a franchisor or a franchise broker (or any agent, representative, or employee thereof) and a prospective franchisee which is held for the purpose of discussing the sale or possible sale of a franchise.

**Premises**" usually means the entire real property, either owned or leased by the franchisee, where the franchise business will be located.

**Principal Register**" usually means the register maintained by the U.S. Patent and Trademark Office where trademarks and service marks are registered giving nationwide constructive notice of the owner's right to use the marks. Once on the Principal Register, the trademark owner is allowed to use the symbol " ."

**Private Label Products**" usually means the products that are manufactured for the franchisor and its franchisees under the franchisor's trademarked label.

**Product Franchise**" usually means the situation where the franchisee sells products produced by the franchisor, or under the franchisor's control or direction, which bear the franchisor's trademarks (for example, automobile dealerships and gasoline stations).



**Proprietary Marks**" usually means the primary mark, trade name and logo used to identify the business and all other trademarks, service marks, trade names, logos and commercial symbols authorized by the franchisor as part of the franchise system.

**Proprietary Property**" usually means the proprietary marks, confidential information and copyrighted information of the franchisor or its affiliates including the manuals that the franchisee is entitled to use under the franchise agreement.

**Prospective Franchisee**" usually means any person, including any representative, agent, or employee of that person, who approaches or is approached by a franchisor or a franchise broker, or any representative, agent, or employee thereof, for the purpose of discussing the establishment, or possible establishment, of a franchise relationship involving such a person.

**Reserved Area**" usually means the area in which the franchisee will undertake its site selection process, if a site has not been selected at the time the franchise agreement is signed, and will submit proposed sites for the franchisor's approval in accordance with its site approval process. The reserved area is usually a city or a county, but usually excludes any protected territory of a company-owned outlet or of another franchisee who already has a franchise business in operation or to be operated in the reserved area.

**Royalty Fee**" or **Service Fee**" usually means the ongoing (weekly or monthly) fee paid by the franchisee to the franchisor. It is usually a percentage of gross sales but may be a fixed amount.

**Secret Recipe Products**" usually means recipes and products created by the franchisor and deemed secret.

**Service Marks**" or "SM" usually means marks used to identify services (rather than goods) adopted, owned or licensed and used by a franchisor in which the franchisor is asserting common law rights to distinguish its services from others.

**Signage**" usually means the signage required by the franchisor for the franchise business bearing the franchisor's trade name or other proprietary marks.

**Software**" usually means the computer software licensed to the franchisee by the franchisor or a third party.

**Subfranchisor**" usually means a person who obtains rights from a franchisor to sell franchises in a certain area.

**Subordination**" usually means the right to step into the shoes of another person to enforce a claim against a third party.

**Succeeding Term**" or **Renewal Term**" usually means the term of the successor franchise agreement or renewal franchise agreement.

**Successor Franchise Agreement**" or **Renewal Franchise Agreement**" usually means the then-current form of franchise agreement for new franchisees which the franchisee must sign when he or she renews the franchise agreement at the end of the term.

**Supplemental Register**" usually means the register maintained by the U.S. Patent and Trademark Office where "descriptive marks" are registered. Registration on the Supplemental Register confers no significant federal trademark protection to the owner. You are not allowed to use the registered copyright symbol "©," but may use "®" or "™"

**Term**" usually means the initial term of the franchise agreement (most often 10 years).

**Trade Dress** usually means the store design and image developed and owned by the including color scheme and special architectural features (for example, McDonald's golden arches).

**Trademark**" or "™" means any word, name, symbol or device or any combination thereof adopted, owned or licensed and used by a franchisor and in which the franchisor is asserting common law rights to identify its goods (rather than services) and distinguish them from others.

**Trade Name**" usually means the name used by all company-owned outlets and franchise outlets on signs and other items to identify the business. (for example, "McDonalds®").

**Transfer Fee**" usually means the fee paid by the franchisee to the franchisor in consideration of approving the sale or transfer of the franchise business and in training the new buyer.

**Turn-Key Franchise**" usually means the situation where the franchisor finds a site, builds the location, installs all necessary furniture, furnishings and equipment to the point where the outlet is ready to open. The franchisor then sells the outlet to the franchisee and "turns over the keys" to the business.

**Venue**" usually means the place (district, county, etc.) where a lawsuit, or mediation or arbitration proceeding will be held. It is usually designated in the franchise agreement.

**You**" is the plain English term used to describe the franchisee as used in an FDD.

Keith J. Kanouse