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When Disillusion Sets In

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Correction Appended

On Nov. 27, Bhupinder Baber walked into a Quiznos restaurant on the outskirts of Los Angeles. He spoke briefly with the manager before stepping into the restroom and shooting himself three times in the chest.

Mr. Baber died that evening. In a note he left behind, Mr. Baber, who had owned two Quiznos franchises in Long Beach before he became embroiled in a legal dispute with the corporation, blamed the sandwich chain for destroying his life.

"Someone must do something about what Quiznos is doing to the trapped franchisees," he wrote. "I deeply regret getting into Quiznos. I wish I had never heard of them."

While extreme, the story of Mr. Baber and his death has been cited by a number of other owners of Quiznos franchises. They say it illustrates their growing sense of desperation and frustration toward the corporation.

A spokesman for Quiznos, based in Denver, says it is "deeply saddened" by Mr. Baber's death and that it would be inappropriate to comment further.

Selling sandwiches piled high with meat, dripping with cheese on toasted sandwich rolls, Quiznos has become one of the fastest-growing food chains. It has grown to 5,000 stores from just 100 a decade ago.

But lawsuits filed by some of the chain's mom-and-pop franchisees in the last year accuse the company of pocketing the $25,000 licensing fees and never finding store locations within an allotted one-year timeframe. Other lawsuits contend that the licensing agreement forces them to buy everything — the meat and cheese for the sandwiches, the soap in the bathrooms, the music played in the stores, and even the payroll and accounting systems — through designated suppliers and distributors owned by Quiznos that charge the franchisees higher prices while paying tens of millions of dollars to the corporation, according to interviews with franchisees and court filings.

The company said last night that it believes there is no merit to any of the cases and that it will deal with each as it deems appropriate.

As costs rise, some Quiznos operators say they are struggling to survive. One lawsuit cites a memorandum drafted by a Quiznos lawyer in 2003 that stated "40 percent of Quiznos units are not breaking even" — a fact that prospective franchisees say they were never told.

A Quiznos spokesman says it does not know what the exact failure rate was in 2003, but that it was "far less" than that.

The internecine war at Quiznos shows the two sides of the franchising coin: the promise and the risk. Lured by glossy brochures, peppy seminars that promise big bucks or the success stories of early McDonald's franchisees, millions of Americans who dream of being their own bosses turn to franchising to do so. More than 2,500 companies, including U.P.S., Choice Hotels and H& R Block, offer franchising opportunities. Sales from franchised companies now total more than $1 trillion a year, according to some estimates.

The dark side of the industry is that many venture into franchising with their eyes shut. For instance, most corporations do not provide accurate franchisee failure rates. And franchisees are usually forced to sign contracts that allow the company to make changes to the agreement even if it harms the franchisee, warns Susan P. Kezios, president of the American Franchisee Association.

"In many cases, you sign a contract in which you agree that you will always be in compliance with their policies and their procedures, but in effect, you are signing a moving target," she said. "When they control how much you are going to pay them in royalties, and advertising and then force you to buy all of your supplies from them, it's not free enterprise anymore. It's indentured servitude."

There have been many legal skirmishes in franchising over the years. These days, however, Quiznos is facing more lawsuits from franchisees than bigger chains like McDonald's, Burger King, Wendy's and even its sandwich rivals Subway and Blimpie, according to an analysis by the legal research firm Thomson West. Yesterday, Quiznos franchisees filed a lawsuit seeking class-action status in Michigan.

To mend fences with its angry franchisees and, some say, to lay the groundwork to take the private company public in the next few years, Quiznos brought in a new chief executive last month, the turnaround specialist Gregory D. Brenneman.

A former consultant at Bain & Company, Mr. Brenneman, 45, is widely credited with fixing Continental Airlines and then improving relations with Burger King's franchisees before the company went public last spring.

Energetic and self-effacing (he blithely declares he works off a one-page turnaround plan and that "none of this is rocket science,") Mr. Brenneman says he became enamored with franchise-based organizations after Burger King and began looking for similar companies to become involved with last summer. He took a stake in

Quiznos through his private equity firm and says he is a fan of the chain's prime rib sandwich.

First up at Quiznos, he says, is improving the profitability of all of the company's franchisees.

"When I looked at Quiznos, it was clear that food costs, as a percent of revenue were, quite honestly, out of line," he said in an interview. "That's going to come in line very quickly."

Since he joined the company, Mr. Brenneman has delivered systemwide voice mails every Friday to Quiznos franchisees providing updates of his goals, which so far include reducing food costs enough so that profits for an average Quiznos should climb by at least $10,000 a year.

Some of the lawsuits, like one filed in New Jersey that is seeking class-action status, say that the astounding growth record of Quiznos is merely a facade. In 2003 and 2004, Quiznos said it sold 234 "trade areas" in the state of New Jersey to franchisees, collecting the $25,000 franchisee fee, but none of these locations ever opened, according to the lawsuit.

Three years after handing over her check for the licensing fee, Elisa Whitehall said she had yet to open a Quiznos in the location she bought and Quiznos refuses to return her $25,000 licensing fee.

In early 2004, after attending a business seminar at a Hilton hotel conference room in New Jersey, Ms. Whitehall was told she could open a restaurant in her selected area, Palm Beach, Fla., within the year. Ms. Whitehall, who owns two Curves fitness franchises in New Jersey that she claims are successful, said from 2004 to 2005 she was shown three locations: an empty lot that could not be developed because of environmental concerns, an existing restaurant that was losing money, and a third spot that turned out to be 35 miles away from where she wanted to open a restaurant. None of the sites were close to what she had agreed upon, Ms. Whitehall says.

"It's almost three years now since I signed the franchisee agreement and even if they called and said they had a store for me, I absolutely would not do it. Every single one around me is closing their doors," Ms. Whitehall said.

From 2003 to 2005, Quiznos collected about $7 million in fees from the 350 franchising licenses that it sold but never found locations for, the New Jersey lawsuit contends.

"Quiznos is selling you a lottery ticket that gives you the chance of opening up a franchise," said Justin M. Klein, the lawyer representing plaintiffs in the New Jersey lawsuit. "They duped these people into thinking they were getting site assistance, but after they plunked down their $25,000, Quiznos would disappear," he added.

A Quiznos spokesman said the company is "working diligently" to make sure everyone who bought a franchise agreement is able to find a location and open a store.

Even though many of the prospective franchisees may have lost $25,000, those are the lucky ones, according to Mr. Klein.

Some franchisees that are able to open restaurants say they wound up struggling to break even amid rising costs for food and other supplies that are sold to them through distributors that Quiznos owns and controls and receives millions in rebates from.

Quiznos franchisees, for instance, are required to buy food from American Food Distributors, a company owned by the Quiznos corporation that acts as a middleman with food-manufacturing companies. In 2005, American Food Distributors received rebates totaling more than $33 million from suppliers, with $17.5 million of that going into the company's national marketing fund, according to a Quiznos franchise document.

A result is that Quiznos charges prices that are higher than what franchisees could obtain on their own, contends a lawsuit filed in Wisconsin in November that accuses the corporation of antitrust and racketeering violations.

A Quiznos spokesman said that American Food Distributors did not break even in 2006 and that the company was committed to lowering costs to franchisees and is making progress in that direction.

Yet, five years ago when John and Dawn Schodron opened a Quiznos in Slinger, Wis., about 30 miles north of Milwaukee, food costs ran about 28 percent of their revenue, Mr. Schodron said. According to budget goals provided by the company, franchisees were told they would not be profitable if their food costs climbed above 28.5 percent of their revenue, Mr. Schodron recalls.

Today, Mr. Schodron estimates his food costs are running in the "mid- to upper 30 percent" range and some double-meat sandwiches top out at 40 percent of revenue. "I called a supplier and was quoted a price for the same type of cheese Quiznos uses that was 40 cents a pound cheaper than I am paying now," Mr. Schodron said. He said he wants to sell the restaurant because rising costs are making it increasingly difficult to break even.

Ms. Kezios of the American Franchisee Association said, "With some franchisors they don't make their money, in truth, off of the royalty fees they collect from the franchisees, but rather, they make money selling products and services to the franchisees." In some systems, like Subway and KFC, the franchisees themselves own or share the supply chain with the corporation, she noted.

But over the years, Quiznos has given few breaks to its franchisees, some claim.

In the spring of 2005, Fredrick N. Westerfield said he sent a letter to Quiznos pleading for a temporary suspension on his royalty payments to the company as he struggled to make ends meet in the three stores he an in Wisconsin. He said he received a phone call back from the company saying there was nothing it could do.

So earlier this year after spending $14,000 in personal savings to keep the stores running in December, the former engineer realized he was drowning in more than $750,000 of debt and that sales were declining even as costs continued to climb. He decided to close all three stores.

He says the stress put a huge strain on his marriage and he will probably lose everything, including his home and cars, in bankruptcy.

'Customers used to come into the store and say to me, 'You must be rolling in the money,' " recalled Mr. Westerfield. "If they only knew."

Correction: March 1, 2007

An article in Business Day on Saturday about problems between Quiznos restaurant and some of its franchises referred imprecisely to the timing of an initial offering by another fast-food chain, Burger King, and the role of its chief executive, Gregory D. Brenneman. Although Mr. Brenneman helped prepare Burger King for its initial offering last year, he did not take it public on May 17; he left the company in April.