NEWS BRIEFS

Quiznos Turns Up the Heat On Disgruntled Franchisees

Quiznos has terminated the contracts of eight of the 10 franchisees who sit on the board of the Toasted Subs Franchisee Association ("TSFA"), significantly ratcheting up the ill will that has developed between a small number of franchisees and the company. The termination notifications follow TSFA's decision in December to publish an alleged suicide note written by franchisee Baber Vhupinder, who killed himself in late November. In the note, Vhupinder blames financial troubles with his Quiznos restaurant and an ensuing lawsuit for his despair.

"Quiznos has elected to exercise its contractual right to terminate for grave and material breach of the franchise agreement," said Fredric Cohen, DLA Piper US LLP (Chicago), who represents Quiznos. Publishing the alleged suicide note brings significant harm to the Quiznos brand and franchise, he added.

However, on Dec. 19, 2006, Judge John L. Kane, of the U.S. District Court for the District of Colorado, issued a ruling that he is "inclined to issue a temporary restraining order to preserve the status quo before the dispute between Quiznos and its franchisees arose," thus putting into doubt whether the franchisees can be terminated.

The suicide is the most tragic event arising from a series of class action lawsuits that have been filed against Quiznos by franchisees in California, New Jersey, and Wisconsin. TSFA assisted in the filing of the Wisconsin lawsuit, and TSFA has been sued by Quiznos for impairing the goodwill of the Quiznos brand.

The New Jersey and California franchisees, none of whom have operating stores, allege that Quiznos' system is rigged — that the company essentially pockets the initial franchising fee, makes them responsible for finding a suitable site, and then rejects every location they find. Neither the New Jersey lawsuit, with nine named plaintiffs, nor the California lawsuit, with two named plaintiffs, has yet been granted class action status.

"Quiznos obtained its growth by overselling territories and promising thousands of unsophisticated business people a chance to open restaurants," said Justin Klein (Marks & Klein), who is representing Quiznos franchisees. "The agreements state that if a person does not open a store within 12 months, Quiznos can keep the $25,000 franchise fee and terminate."

The Wisconsin lawsuit was filed by 13 active franchisees, who allege that they are being overcharged for required purchases of goods. The Wisconsin lawsuit, which focuses on complaints of operating restaurants, alleges violations of antitrust and RICO statutes, as well as Wisconsin's fair dealership laws, said Klein. He added that the franchisees allege that they are "pressured to invest in a system in which their required purchases of supplies and services are rigged to benefit the franchisor." Many of the supplies and services (accounting, cleaning supplies, etc.) do not have a direct impact on the customer's brand experience, he added.

Quiznos has countered in court filings that its franchise agreements make it clear that finding a suitable site is solely the responsibility of the franchisee, and the franchisor has the right to accept or deny a proposed site. With competition for high-caliber sites for quick-serve restaurants intense, Quiznos believes it is protecting franchisees from opening in poor or over-priced locations, said Cohen.

Furthermore, noted Cohen, Quiznos has not terminated many of the prospective franchisees who missed the one-year deadline, and it has worked with hundreds of franchisees to try to help them find sites, despite having no contractual obligation to do so. Far from wanting to reject new restaurants, Quiznos has done everything it could to help them open, he said. "Quiznos' out-of-pocket expenses for a new franchisee exceed the [franchise] fee. Quiznos makes its money on royalties from ongoing franchise operations; it's not making any money until a store is open, so its interest is in having successful stores in top locations," Cohen said.

Klein agreed that Quiznos has not typically exercised its right to termination. But he argued that Quiznos has pressured franchisees to take over failing Quiznos restaurants in other territories, rather than losing their payments. "The stores are so expensive to own and operate that these franchisees [in poor locations] are probably better off losing the $25,000," Klein said. "Quiznos has been overselling stores in poor locations."

Also, in some New Jersey territories, Klein said that Quiznos has rejected different sites found by multiple franchisees over several years. "I have examples where three different franchisees were never able to open in a territory," he said.

Cohen said that Quiznos is confident that none of the lawsuits will succeed. Both the New Jersey and California lawsuits were filed initially in state court, and the New Jersey complaint has been moved to Denver. "We intend to challenge the legal sufficiency of the complaints and challenge class action certification," said Cohen, speaking with FBLA a few days before Quiznos was due to respond in the New Jersey complaint and a month before the California complaint deadline. "I would go so far as to say that the complaints are inherently uncertifiable as class actions."

Given that Quiznos has 10,000 franchisees (operating and signed-and-paid contracts), the number of complaints is actually quite low, said Cohen.

Yet Klein said that more class actions are coming. "I get calls every week from franchisees who say they have read the New Jersey or Wisconsin complaints, and the same things have happened to them," he said.

—❖—