

# THE WALL STREET JOURNAL.

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## FRANCHISING

# Tough Times for Franchising

As Business Disputes Spark Tensions, Some Franchisees Take Franchisers to Court

By **SARAH E. NEEDLEMAN**

February 9, 2012

Two closely watched disputes now playing out in the courts are shining a spotlight on tensions between franchise owners and management.

The growing rift between franchisees and franchisers—businesses that collectively employ roughly eight million people in the U.S.—follows three consecutive years of declines in the number of U.S. franchises, and as economic pressures prompt people to limit discretionary spending.

Late last month, an association made up of roughly 185 U.S. franchise owners filed a lawsuit against Cold Stone Creamery Inc., a subsidiary of Kahala Corp. , accusing the ice-cream chain of refusing to provide detailed information about funds that the franchisees believe should be set aside for their benefit in a marketing fund.

The lawsuit, which seeks declaratory relief, is asking the court to force Cold Stone to provide the franchisees with information on how much of the rebate money it receives from its approved vendors is actually used for marketing purposes. The Cold Stone franchisee association is also demanding insight into what the company does with revenue and interest generated from sales of unused gift cards.

"We're paying too much for our products and we're making less profit every year," said Frank Caperino, who is part of the association that filed the lawsuit in Miami-Dade County, Fla., state court. Mr. Caperino currently owns two Cold Stone Creamery stores, both in San Diego, which he would like to sell.

A spokeswoman for Kahala, whose other franchise brands include Blimpie sandwiches



Frank Caperino is part of a franchisee association that filed a lawsuit against Cold Stone Creamery. *SAM HODGSON FOR THE WALL STREET JOURNAL*

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## LIVE BLOG

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Follow WSJ small business reporter Emily Maltby's Financial Summit session at this weekend's International Franchise Association from Orlando, Florida on Sunday, Feb. 12 at 9 a.m. ET. Ask your questions about the state of franchising and she'll pose them to the panel. Ask your questions now.

and Samurai Sam's Teriyaki Grill, said in an emailed statement that company policy prevented her from commenting on "pending legal matters."

Management's response to the group's lawsuit hasn't yet been filed. "We are confident with our position," she said.

Cold Stone Creamery, of Scottsdale, Ariz., has roughly 1,500 locations in 17 countries.

A typical Cold Stone Creamery franchise posted \$352,000 in revenue in 2011, down

from \$400,000 in 2005, according to the group of franchise owners who filed the lawsuit. It is difficult to know how much of the declining profitability for franchise owners may be due to the economic downturn, or what the group says is management's poor decision making.

At least a dozen new franchisee associations have risen out of conflict in the past year, according to several attorneys who helped these associations to incorporate. They are "forming at a faster rate than ever before" and "they're taking a more aggressive and more vocal stance," says Robert Zarco, the Miami attorney who is representing the Cold Stone franchisee group.

"At the end of the day, it just boils down to profitability," said Eric Stites, managing director of Franchise Business Review, a market-research company in Portsmouth, N.H. "When franchisees aren't making money, that's when you see them form associations and sue the franchiser."

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## FRANCHISEES VERSUS FRANCHISER

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An association of Cold Stone Creamery Inc. franchisees filed this complaint in a Florida state court last month against the Scottsdale, Ariz.-based chain.



- More photos and interactive graphics ([http://online.wsj.com/public/page/0\\_0\\_WP\\_2003.html](http://online.wsj.com/public/page/0_0_WP_2003.html))

The food sector was hit particularly hard during the recession, as many people cut back on eating out. On average, food franchisees make a profit of \$88,382 annually and pay an initial investment of \$450,000, according to Franchise Business Review.

Specialty chains like Cold Stone Creamery may have suffered more than other chains, Mr. Stites said. Trade publication Franchise Times estimates that Cold Stone's systemwide revenue fell 1.1% to \$493 million in 2011 from 2010.

The Kahala spokeswoman declined to provide specifics on the profitability of the typical franchisee or the figures provided by third parties.

Franchisees typically sign lengthy agreements that require them to follow the rules of the franchiser, which commonly require arbitration to resolve a dispute, thus restricting their ability to file individual lawsuits.

"Litigation sends a signal to the franchiser and others that something is wrong," said John Gordon, an independent chain-restaurant analyst in San Diego who served as an expert consultant on a Burger King case.

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## SMALL TALK

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### So You Want In? How to Assess a Franchise Opportunity

In that case, in November 2009, Burger King Corp. franchisees sued the fast-food company, claiming that it acted in bad faith when it mandated that its double cheeseburgers be sold for just \$1. A settlement was reached last April. As part of

the settlement, Burger King agreed to come up with a new systemwide policy for making decisions about what is listed on its value menu.

In September 2010, a group of Edible Arrangements franchisees filed a lawsuit against Edible Arrangements International Inc., claiming management "abused its discretionary authority" when the fruit-basket chain operator mandated in March 2010 that all U.S. locations must be open on Sundays and stay open for an additional two hours every other day of the week. The decision was made "with little to no regard for the individual needs or surrounding demographics of its franchisees," according to the complaint filed in the U.S. District Court for the District of Connecticut.

"Our franchise agreement is illusory," said Sherri Vertorano, an Edible Arrangements franchisee in Mooresville, N.C., who is part of the lawsuit. "It's like a living, breathing document that changes whenever the franchiser wants to create another revenue stream."

Ms. Vertorano and about 200 other franchisees are also seeking to stop Edible Arrangements management from collecting 2% of gross sales on orders placed over the Internet, among other grievances, according to the complaint. That fee was implemented last month, the company said.

Tom Downes, owner of an Edible Arrangements outlet in Portsmouth, N.H., said he is frustrated with the requirement that his business maintain Sunday hours. The 53-year-old said he averages about \$1,000 in sales on weekdays but on a recent Sunday he made \$23.

Tariq Farid, president of Edible Arrangements, denied the allegations in the lawsuit and said any new operating procedures the company implements are intended to benefit its franchisees, not hurt them.

Mr. Farid, who founded the company in 1999 and began franchising it in 2001, declined to provide specifics on the profitability of the typical franchisee. The Wallingford, Conn.-based company has more than 1,000 outlets, and posted \$425 million in systemwide revenue last year, up from \$380 million in 2010.

Management has been investing more in social media and ecommerce, for instance, to help the franchise owners keep up with current consumer taste. "At the end of the day, if you deliver results, they'll respect you," Mr. Farid said of franchisees.

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