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Some Quiznos franchises riled

The critics and lawsuits don't alarm the president of the rapidly expanding Denver-based eatery

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Quiznos president Steve Shaffer relaxes in a test kitchen at the chain s Denver headquarters. The complaints and suits of franchisees are normal for a company of Quiznos size, he says. (Post / Jerry Cleveland)

Quiznos, the Denver-based submarine-sandwich giant, deployed 20 people dressed as soft-drink cups to walk around Las Vegas last month during a big shopping center convention.

The "cups" distributed fliers - to conventioneers, gamblers and tourists - offering sandwich and drink discounts. At the convention, workers for the 4,000-restaurant chain wore T-shirts trumpeting their company's need for 2,000 more restaurant sites.

Both efforts highlight Quiznos' attempts to stand out. Company president Steve Shaffer characterizes the privately held chain, founded in 1981, as an underdog eking out market share in the shadow of giants.

His attitude belies this reality: Quiznos already opens more branded restaurants in the U.S. each year than all but two companies, Subway and Starbucks.

The toasted-sub seller has grown from a single store near Colorado's gold-domed Capitol to 4,000 restaurants worldwide. By two measures - percentage increase in stores and system- wide sales growth - it is the country's fastest-growing restaurant chain, according to the rankings issued last year by Nation's Restaurant News.

Sales crossed the billion- dollar mark for the first time in 2004, settling at $1.275 billion, the company says.

But such speedy growth has come with a price: Quiznos also contends with a growing list of disgruntled franchisees.

Their complaints, typical in the franchising world, range from excessive food costs, lack of support from the company and cannibalization because the company allows competing stores too close together. The company also sells franchises but can't provide locations, other franchisees complain in a New Jersey lawsuit.

The complaints come from a small group of operators who are raising a fuss because they're unsuccessful operators, Shaffer counters.

"There will always be top stores and bottom stores in the system," Shaffer said. "Our job is to make sure the bottom stores don't stay in the system. That creates hard feelings."

Selling franchises on TV

Five years ago, Quiznos' corporate office employed just 100 people. Today, it has 400 people downtown and 150 more throughout the country.

While Quiznos uses toasted subs and kitschy advertising to woo customers, it has a more aggressive tactic for winning franchisees. It uses direct mail and, in May, became the first U.S. restaurant franchiser to use a late- night infomercial to sell franchises.

The 30-minute spot, which ran for a week, featured happy franchisees talking about the advantages of owning a Quiznos. The infomercials encouraged interested people to attend informational meetings at hotels.

Both the infomercials and hotel sales meetings are novel tactics for franchisers - especially restaurants - said Bob Purvin, chairman of the American Association of Franchisees and Dealers. "That's scary to me, because in theory you would want to go after a franchisee the way an executive recruitment firm would go after a quality candidate for a job," Purvin said. "A lot of franchisers will advertise in the business opportunity section of The Wall Street Journal or USA Today."

Response to the infomercials was strong, but the company is still determining whether the response resulted in enough qualified leads, Shaffer said.

After all, one-time franchise fees for the company are $25,000 for a single unit, and the cost of opening a store - borne entirely by the franchisee - is upwards of $200,000, depending on the locale.

Franchisees also pay royalties on gross sales of 7 percent and contribute 4 percent to an advertising fund. They also must buy food and supplies from designated vendors.

A maze of fees, costs

Some franchisees who paid those fees said they're barely breaking even.

"I was doomed from Day One," said Ashwin Patel, a software-industry employee from

Minneapolis who viewed owning a Quiznos as a backup in case he lost his job during the economic downturn.

Patel signed a franchise agreement in September 2002. He said the company offered him a location in December 2003. He worried the site wouldn't get enough traffic, but he accepted because he worried he would otherwise forfeit his contract.

Patel's store opened in May 2004 and closed in December. A big factor in the failure was a lack of pedestrian traffic, he said.

Patel lost more than $200,000 on his franchise. Quiznos' marketing staff did little to help him drum up business while he was struggling, he said.

Quiznos counters that it goes to lengths to help struggling operators improve their operations.

Representatives visit each store every six weeks to conduct inspections and review restaurant operations. "Market meetings," where franchisees can learn about new campaigns and hear what other franchisees are doing, are conducted five times a year.

In addition, Shaffer said, franchisees may call the company's Denver headquarters for help.

Patel and other franchisees said the company's food costs also made it difficult for them to be profitable. Food costs ran at more than 30 percent of their gross sales - more than they were told to expect, they say.

Shaffer said the company does not make any promises about what franchisees should expect food costs to be - or how much profit they should anticipate.

"I'm spending almost 30 percent on food and another 15 to 20 percent on labor," said Karen Woodland of Detroit.

Woodland sold one of her Quiznos locations and is trying to sell a second, money-losing location. She recently contacted an attorney about filing for bankruptcy, she said.

Several franchisees said they believe the company has failed to use its size to negotiate better prices and instead is focusing on the referral

fees it gets from vendor contracts.

Quiznos is not so large that it can negotiate the same prices as larger chains. It also uses higher-quality ingredients, he said.

Franchisees could get cheaper soda at warehouse clubs such as Sam's Club, Shaffer said, but that opens the gates to allowing other warehouse-club purchases that could compromise the chain's consistency and quality, he said.

A third complaint is allowing new stores to be built too close to existing ones.

Five Quiznos franchisees in Phoenix last year filed a lawsuit against the company alleging fraud and deceptive trade practices because the company was putting stores too close together. That case was later thrown out.

A similar case filed by Lakewood franchisee Krmpotich LLC is pending in Denver District Court. In its lawsuit, Krmpotich says the opening of another Quiznos in the immediate area will harm its operations and is a breach of contract.

Encroachment cases are difficult to win because contracts do not normally spell out how closely a franchiser can place stores, franchise attorneys say.

Indeed, materials distributed to Quiznos franchisees say that the company may locate wherever it chooses.

Quiznos says it puts new stores in places where they make sense. The company makes its money from royalties and is not in the business of hurting its franchisees, Shaffer said.

But the company does not disclose individual store profits. It reports average annual store closings and turnover of 3 to 4 percent, below the franchise- industry standard reported by research firm Frandata as 7.2 percent.

Shaffer says the company's new stores aren't cannibalizing existing ones. He notes that average store sales volumes have increased to $436,000, compared with $380,000 in 2002.

Denver Quiznos franchisee Ron Boudreaux is surprised by some franchisees' complaints. His store at 17th and Larimer streets downtown has consistently made money, even with three competing stores within a six-block radius, he said. Sales are up nearly 15 percent this year.

"We do a lot of marketing. We burn a lot of leather getting out there and promoting ourselves," said Boudreaux, who has owned his store with wife Judy since 2002.

Trouble at the outset

While the company contends with complaints from franchisees whose stores are open, another group says its problems started before they opened.

A group of New Jersey franchisees sued Quiznos alleging the company took their franchisee fees but failed to approve locations, causing them to forfeit those fees.

The suit listed 17 plaintiffs, but it has grown to 27, said Justin Klein, the attorney representing the franchisees.

The franchisees said they were told after purchasing certain "trade areas" that the company would locate sites for them. But the company didn't locate sites and didn't approve sites suggested by the plaintiffs, according to the lawsuit.

"They tell you not to approach brokers or landlords and that they'll do the negotiation for you," said Lisa Tolan, a plaintiff, who signed a franchise agreement in April 2003.

She said the company stopped responding to her inquiries, then sent her a notice of default on its franchise agreement because no location had been found.

Shaffer said the suit would "ultimately prove frivolous" because the company's contract spells out that franchisees are responsible for securing their own locations. Deadlines are frequently extended as long as franchisees are working in good faith to find a space, he said.

Quiznos is dealing with the complaints, Shaffer says. As the company gets bigger, the number of franchisees on the bottom rungs in terms of performance will also grow, he said.

Still, Quiznos plans to forge ahead.

"As long as it makes sense to grow," Shaffer said, "we will."

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Franchise footrace

Restaurant chains by number of restaurants opened in 2003:

Subway: 1,977

Starbucks: 959

Quiznos Sub: 717

Dunkin' Donuts: 435