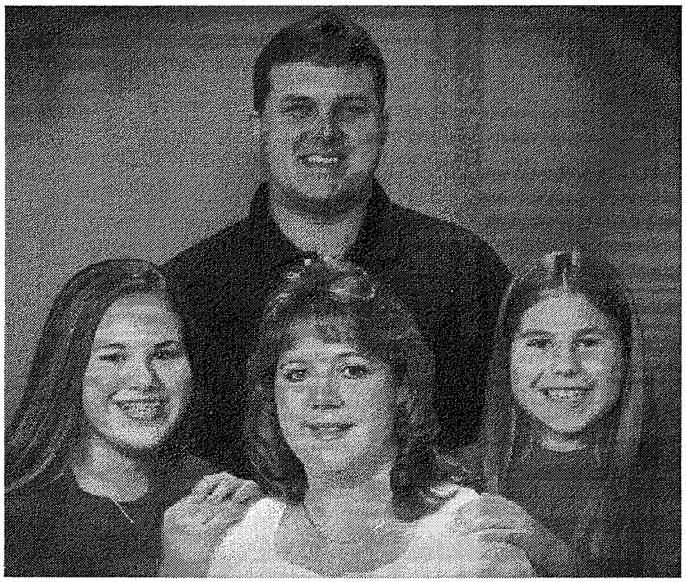
A BAD MONTH IN COURT FOR SNAP-ON
TOOLMAKER COULD BE FACING CLASS ACTION SUITS

Snap-On Suffers Twin Reverses in Legal Disputes
65% Attrition Rate Has Ex-Franchisees Charging "Fraud"

June 28, 2005— Tool manufacturer and franchisor Snap-On (NYSE: SNA) suffered two legal reverses this month. The decisions mark a growing danger for Snap-On of expensive court or arbitrator decisions in favor of the thousands of Snap-On ex-franchisees who lost money as a result of their Snap-On experiences.

On June 8, an arbitrator delivered a decision which opens the way to a class action lawsuit against Snap-On. Rejecting the arguments of Snap-On's lawyers, the arbitrator said that Snap-On's franchise agreement does not rule out class actions against the company. A class action could potentially unite thousands of ex-franchisees in a single legal action, where they have more resources and could potentially win larger damages. Other class action cases against franchisors have led to awards in excess of $100 million. "There are still some hoops to jump through, but this decision has nationwide ramifications," said Jerry Marks, lawyer for Tony Hobby, the Florida ex-franchisee involved in that case.



Tony Hobby today: "I've seen corporate greed first-hand."
"I put Snap-On in the same category as WorldCom or Enron. Maybe they didn't bilk investors out of billions of dollars, but they hurt a lot of working guys and their families. It's something you never really get over. I'm changed for the rest of my life."

In the other decision, the Superior State Court of Middlesex County, New Jersey authorized Snap-On wife Nancy Casey to continue with her lawsuit against the franchisor. The so-called "Wives Against Snap-On" are a group of women who are so angry over the financial and emotional damage they say they suffered while their husbands were franchisees that they have banded together, created a website that criticizes the company (www.snap-onfranchisefraud.com), and taken legal action against it. Snap-On argued that Casey was required to go to arbitration, and not civil court, by the Snap-On franchise contract signed by her husband Brian. The judge said no.

"The court said that this case involves fraud outside the contract," said Marks, who is also Casey's lawyer. Casey's case now moves into the discovery phase. "We are highly confident we will discover facts and evidence that strongly support our case," Marks said.

At the heart of both cases, according to ex-franchisees, lies a pattern of behavior which enabled Snap-On to drive up revenues by signing up franchisees with inadequate customer territories, and then selling thousands of dollars of tools to each franchisee and to their end-customers, much of it on credit. When the franchisee failed to generate enough income to meet his obligations under the franchise contract, those tools were taken back from the franchisee and re-sold.

According to Justin Klein, another lawyer at the Marks Law firm which represents numerous ex-franchisees of Snap-On, in the late 1990s Snap-On implemented a program called "More Feet on the Street" to drive up the number of franchisees as a way of increasing revenue and profits. The typical Snap-On franchisee "territory" is actually a list of 200 existing Snap-On customers. These are supposed to be mechanics working at auto service stations or similar businesses where they are required to bring a full set of tools to their job. But in many cases the list included mechanics who worked at businesses that required few, if any, of the heavy-duty wrenches, screwdrivers, socket sets, engine diagnostics, and glossy cabinets-on-wheels that Snap-On is known for. "In many cases, the customer lists included golf courses, doctor's offices, and other businesses where there few if any mechanics who bought tools on a regular basis," Klein said.

The result? Hundreds of franchisees quit the business—but usually only after they were deeply in debt to Snap-On. Klein says the typical lifespan of a Snap-On dealer who signed up in the late 1990s was three years. "Between 1998 and 2003, according to our calculations and based on Snap-On documents including their Franchise Offering Circular, 2308 dealers left the Snap-On system. They were replaced by 2430 new dealers. That's out of a total number of US dealers of around 3500," says Klein.

Klein's figures work out to an attrition rate of 65%. One franchise expert has said that any franchise with an attrition rate of over 25% is likely to be a scam. High attrition rates mean franchisees are failing to make money in their business. The franchisor may be profiting from keeping a large number of franchisees out in the marketplace and he may be omitting to tell the franchisees what he knows about the poor prospects they face.

Tony Hobby's case illustrates how the Snap-On franchise system operated. Hobby was an auto mechanic, aged 33, when in late 2001 he signed on as a Snap-On franchisee, with a territory near his home in Tampa, Florida. He put up almost no cash, borrowing over $100,000 from Snap-On to pay for his license fee, his customer list, his truck, and his inventory of tools.

Hobby's first shock as a new franchisee came when he did his rounds and met his supposed customers. He found they included customers working at stereo repair shops, lawn mower repair shops, and big-box electronics retailers. Even at car dealerships, Hobby found the older mechanics already had their tool kits and had little interest in investing in new Snap-On product.

"Two hundred people sounds like a lot of customers at first," Hobby recalls. "But I had guys at Best Buy and Circuit City. They don't buy thousands of dollars of tools a year." Under the franchise rules, he was prohibited from going out and finding new customers.

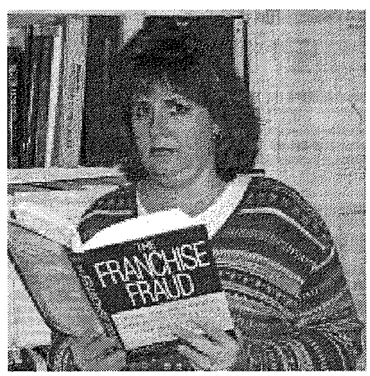
The second big problem was Snap-On's addiction to the credit drug. Each franchisee is required to carry $125,000 of inventory on his truck. Customers are pushed to buy tools on credit. (In Snap-On's 2004 Annual Report, the company boasts about implementing a cellphone-based system where credit approvals can be text-messaged to franchisees almost instantly). Hobby cites a typical case of a sale of a set of screwdrivers for $125 to a customer. The customer might agree to pay $25 a week for that set. But Hobby has to buy a new set from Snap-On immediately, at his cost of around $75. Result: the sale's immediate impact is to reduce Hobby's cash flow for at least a short period—and that's if the customer is still there when the dealer calls by again. "In Florida, a lot of auto mechanics move all the time," Hobby says. On top of that, Hobby was responsible for any debts his customers didn't pay. "At a GM dealer, if you buy a car and the credit comes from GMAC, GM doesn't make the dealer pay if you can't make your loan payment. But at Snap-On, the franchisee gets penalized if a customer doesn't pay his bills."

Unable to reach his break-even revenue of $6500 a week, Hobby's debt to Snap-On grew. When he was unable to meet the minimum requirements for paying off that debt, they cut him off and stopped shipping tools to him. Then he was terminated, and Snap-On lawyers threatened legal action to recover the $200,000 they claimed he owed. Faced with the threat of a legal action against him, Hobby found the Marks Law firm. They told him he was far from unique in his situation and filed an action on his behalf charging Snap-On with fraud.

"It's fraud because Snap-On didn't properly disclose a lot of information they knew. Snap-On knew that a lot of these people would never make it," says attorney Klein.

Asked why he took legal action against Snap-On, Hobby replies: "I was an auto mechanic and I always wanted to have something of my own. They take advantage of people who are super-naïve about business. It's not only about the money. It's a lot of stress on your family. It's a lot psychologically to have that big a failure, and when you look around and see other people who went through the same thing, you start saying to yourself there's something wrong here."

Nancy Casey tells a similar story. Her husband Brian Casey, an electrician, purchased a Snap-On franchise in 1998, in New Brunswick, New Jersey. They used $40,000 cash which Nancy inherited when her parents died. At first, Brian did very well, even winning an award as "Rookie of the Year" for the East Coast region. With encouragement from his regional Field Manager, Brian signed up for a second Snap-On route. That one turned out to be much worse than the first. Debts started to pile up and sales couldn't keep pace. Nancy, who did the books for Brian's business, found that what sales they had were insufficient to stop the debt from mounting. "They kept shipping us tools, and they never took anything back. When we finally said we couldn't go on, they told us: you need to go out and re-mortgage your house. That was when I said enough is enough."



Brian Casey took Snap-On to arbitration, charging fraud over misrepresenting the customer list. Facts that came to light in discovery supported the Caseys. "We were able to uncover so many things done wrong," Nancy says. "Our Field Manager was shipping tools and expensive tool boxes to our house and having them put on our invoices without our consent. He forged my husband's signature on documents. It was unbelievable."

In June 2004, the arbitrator awarded Brian Casey $315,000 in compensation and released him from the debts Snap-On claimed he owed them. His former Field Manager is no longer with Snap-On.

So if Brian has already won his case, why is Nancy taking Snap-On to court again as a "Snap-On Wife"?

"I'm trying to show how they almost tore my family up and desecrated my financial future. They will drain a family of whatever nest egg you have and just leave you with nothing."

Nancy is still angry over her experience with Snap-On, especially the final year of Brian's five years as a franchisee. "My husband went into a deep depression. He would leave every morning before 6am and wouldn't get home till midnight. We had just had our third child and we had no family life. There was no communicating with him.

Nancy Casey wants to follow her husband's arbitration victory with one of her own.

"They are in the business of selling franchises, not tools."

"Then, when we weren't able to pay the bills, they cut off my husband's ability to get tools. Customers stopped paying their weekly bills. There were days he wouldn't get out of bed because he couldn't face his customers."

Real Deal requested interviews with Snap-On CEO Jack Michaels and CFO Marty Ellen and received no reply. We wanted to ask them if they have calculated the potential damages a class action suit could cost Snap-On. We also wanted to ask them whether attrition rates have improved from the 65% level, and what has happened to the bad debt from all those Snap-On sales to franchisees and customers who didn't pay. Only by subtracting out bad debt figures could anyone determine what is Snap-On's true level of sales—as opposed to the sales figures they report to Wall Street investors. They did not return repeated telephone calls.

One man was willing to talk to us. Henry Berghoef, the director of research at Harris Associates, defended the new Snap-On management, which dates from November 2004. Harris, the manager of the Oakmark group of mutual funds, has accumulated a position of 6% of Snap-On's stock, worth some $117 million. The Oakmark funds are highly regarded on Wall Street, known for taking bold positions in beaten-down companies with well-known brand names where they see potential for a turnaround. "We bought stock when the new CEO came in," Berghoef said. "This company was poorly managed for a long time, and Jack Michaels has a terrific track record and he will bring a lot of change."

Berghoef admitted he knew little about how the franchise system operates. "I hope the new management makes the franchise system better," he said.

Tony Hobby now works as a mechanic at a Tampa Ford dealer and he doesn't believe much has changed. "The other day we had a Snap-On dealer in, and he was talking about how his bills just keep going up.

"It's the same old story."

A Bridge Too Far?
Snap-On's dealer numbers fell 7% in the year to March 2005 to a total of 3850. CEO Michaels says dealer numbers will begin to rise again "later in the year."