

## Restaurant Brands International: Lawyer in Quiznos Class Action Discusses Tim Hortons' Franchise Disclosure Document and Practices

### Company Update

*The Capitol Forum* recently asked Jerry Marks of Marks & Klein, LLP – a franchise law expert and an attorney for Quiznos franchisees [who sued](#) Quiznos resulting in a [settlement](#) of \$206 million – for takeaways based on his review of sections of the most recent Tim Hortons [Franchise Disclosure Document](#) (FDD), a 2017 [complaint](#) filed by Show Me Hospitality, and an October 2017 [letter](#) sent by the U.S. Great White North Franchisee Association (GWNFA).

Marks identified the following red flags regarding language Restaurant Brands International's (RBI) used in the FDD as well price comparisons in GWNFA's letter, which are discussed below.

**Reasonable mark-up and royalty.** Item 6 of the [FDD](#) states that franchisees will pay a royalty between 4.5% and 6% of gross sales to the franchisor. In addition to the royalty payment, sales to franchisees—as opposed to end customers—is a significant source of revenue for both Tim Hortons and RBI.

Indeed, the FDD states, “We may derive revenues from your purchase of Items from us, our affiliates and other approved suppliers. We and our affiliates may charge what we consider to be a reasonable mark-up on items sold to you.”

The key word, according to Marks, is ‘reasonable.’ “A reasonable mark-up would be an administrative charge of somewhere between 2%-7%.” Additionally, “an unreasonable increase in supply costs would be an ‘undisclosed royalty,’ making the royalty charge statement in the FDD inaccurate,” Marks said, which could expose RBI to breach of contract claims.

A franchisee would expect royalties to be the primary way of remitting money to the franchisor after initial purchases and fees are completed. An ‘unreasonable’ mark-up on required purchases would have the same effect as increasing the royalty percentage, as franchisees would be forced to pay RBI more to continue operation of the restaurant.

One piece of evidence that could call into question the reasonableness of the mark-up is the price comparison between Tim Hortons and a competing restaurant franchise conducted by GWNFA. For all but two of the products, the other franchisor charged less than RBI.

**Price gouging.** The price comparisons in the letter could also be used to demonstrate price gouging. “A 46.7% price differential that Horton's US competitor charges its franchisees for Diet and regular Coke is gouging, as is 39% differential for 9 inch plastic straws,” said Marks, based on the figures contained in the letter. “The gouging is a violation of the implied covenant of good faith and fair dealing.”

“All of the above were present in the Quiznos case for which my firm obtained a \$206 million class action settlement against the franchisor,” said Marks in reference to price increases, the possible ‘undisclosed royalty’, and the violation of the implied covenant of good faith and fair dealing.

### A Closer Look at Similarities Between Quiznos and Tim Hortons

**Misuse of Ad Funds.** As part of the Franchise Agreement, franchisees are required to pay a percentage (usually 4%) of gross sales into a national Ad Fund. Both GWNFA and Show Me Hospitality [allege](#) that RBI is not using the money in the Ad Fund to provide marketing support to franchisees, which would violate the franchise agreement.

“Upon the takeover of TDL by 3G, TDL began charging operational/administrative expenses to the Ad Fund that were not previously charged to the Ad Fund and are not properly chargeable to the Ad Fund,” reads paragraph 34 of the Statement of Claim filed by GWNFA.

The Quiznos class action suit contained similar allegations regarding the Ad Fund. The complaint alleged that Quiznos violated franchise agreements by using the advertising fee “for self-serving purposes, including selling more franchises to unwitting customers.”

**Obstruction and lack of reasonable support.** Show Me Hospitality [alleges](#) that RBI withheld approval for new restaurant sites for an unreasonably long time without cause, resulting in Show Me Hospitality falling further behind on its development schedule.

Tim Hortons franchisees are not permitted to begin building or operating at a site without prior approval from RBI. Similarly, the Quiznos class action alleges that “Quiznos has further breached its contractual obligations to Plaintiffs and the Class as follows: (a) failing to provide promised support and assistance in operating franchises.”

RBI did not respond to our request for comment for this article.