Quiznos Settlement Finalized, among Highest Penalties in Franchising

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CHICAGO —Quiznos encountered a franchisee revolt so vast that it has been forced to settle, following years of litigation brought by literally thousands of its franchise owner-operators. Last Friday Judge Rebecca R. Pallmeyer filed an order and dismissal in federal court that brings to a close the lawsuit. The deal promises to provide over $206 million to Quiznos sub sandwich shop owners and to the system as a whole, one of the highest recorded settlement amounts among restaurant franchisors.

The settlement offers a variety of monetary payments to individual plaintiffs as well as discounts on food and other supplies, depending on their status with the company. It will also provide debt forgiveness regarding royalty payments, advertising fees, and other monies owed. As part of the offer, Quiznos will make changes to its method of operations. It is also required to create an independent franchisee association to represent the self-interests of store owner-operators and to push back on Quiznos' aggressive maneuverings with franchisees.

The court gave franchisees the opportunity to opt out of the settlement and to voice their objections prior to a January 30 deadline. According to Quiznos outside counsel Fredric “Ric” Cohen of Cheng Cohen LLC there was only a single objection, which was insubstantial. When asked if the majority of franchisees did not respond one way or the other to the settlement offer, which automatically placed them as approving the settlement, Cohen responded, “That is always the case in class action litigation. However, in our case the participation rate was significantly higher than what is typical in these types of cases.”

One former franchisee spoke out about the final settlement. Chris Bray, founder and former president of the current independent Toasted Subs Franchisee Association, who now acts as consultant to the group, said, “The end result is a far cry from what was hoped for when this litigation was initiated. It fails to address or resolve, in any significant way, any of the issues for which the lawsuit was originally filed. It gives temporary relief to some, and only partial restitution to others.”

Bray quickly added, “Given, however, that franchisees who are most affected by this litigation failed to express a level of dissatisfaction required to change the end result, it should come as no surprise to anyone that the court ruled accordingly. Justice may be blind, but not always fair.”

In past litigation, franchisees have accused the franchisor of operating deceptive business practices since 2000. Operators alleged that the franchisor induced unwitting prospects to purchase Quiznos sandwich shops. Thousands didn’t even receive a shop for their money. In the lawsuit, these were referred to as SNO, or sold but not opened shops. Plaintiff franchisees depicted a franchisor that exploited its control and power “in order to extract exorbitant and unjustifiable payments from franchisees." Quiznos is accused of implementing slick sales tactics to market the American dream of business ownership in what was referred to as the fastest growing franchise in the United States.

These franchise practices have cost Quiznos a settlement with its thousands of aggrieved franchisees worth $206 million. Its network has also seen dramatic shrinkage.

The settlement arrangement allows Quiznos to deny the guilt of all claims in the lawsuit, avoiding any admission of liability.

Attorney Justin Klein of Marks & Klein, who represented the franchise owners in class lawsuits through the years said the final version is the same as the preliminary settlement presented to Judge Pallmeyer on June 30. He said, “We are very pleased with the settlement. It is the result of extremely hard work by not only the lawyers but the franchisees. We are optimistic about the future of the Quiznos franchisees. We are also encouraged by the message that this case sends to the franchise community and the ultimate goal of fairness in franchising that we are working towards.”

Analyzing the Settlement

Chain restaurant analyst and management consultant John A. Gordon said to his knowledge this is the largest or one of the largest legal settlements for franchised restaurant chains in U,S. history. “Ultimately, in America, money talks. The size and breadth of the agreement will send notice to others. My belief is that this settlement will be an impetus for future reform.”

Gordon, principal of Pacific Management Consulting Group, said, “As is well documented, Quiznos' franchise strategy, its store level economics and business model were deeply flawed. This can be seen in the decline of Quiznos Average Unit Sales (AUV) year by year and the large number of U.S. store closures (end of year count 2009, 3696 units versus 4636 at the end of 2007), a decrease of almost 20 percent or 1,000 units in two years. Quiznos' supply chain strategy of capturing large markups for itself is inherently unsound.”

Gordon said Ray Kroc, the milkshake salesman who became a founder of the McDonald's hamburger empire, figured out in the 1950s that franchising works best when franchisors help franchisees profit. Quiznos did not follow franchising best practices, such as executing a small focused footprint of units for franchise development. It also overdeveloped markets.

Gordon said the most important thing in the agreement is that over time there will be the creation of a franchisee advisory council, franchisee marketing committee and franchisee supply-chain price-auditing board.

“Quiznos will have to reform its business and franchising model before it can go public,” the analyst said. “The current intensity of chain restaurant competition, paucity of capital funds and scarcity of refranchising buyers make it difficult for even high performing franchisors.”

Representatives from Quiznos could not be reached prior to publishing.