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Attorneys Criticize Dunkin' Donuts Litigious Behavior

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CANTON, Mass. - Recently, it has been reported in various news articles that there were approximately 350 lawsuits between Dunkin' and its franchisees. The company has been accused of aggressively targeting shop owners in an effort to terminate franchise agreements and in the process collect hefty fees and penalties for alleged contract violations.



Franchisee attorneys Robert Zarco and Robert Salkowski, photo/bmm

Following Dunkin' Donuts Independent Franchise Owners' (DDIFO) twentieth annual meeting in September, president Jim Coen issued a letter to members stating that the association takes the position that it favors a more collaborative approach to reconciling the problems that **Dunkin' Brands** sees the need to litigate against. He declared, "Dunkin' Brands continues to pursue litigation against franchisees and shows no signs of changing their seemingly harsh and predatory practices."

According to Coen, DDIFO is willing and able to take this discussion with Dunkin' behind closed doors, but the franchisor has not shown as of yet, their willingness to do so. He explains, "Keep in mind that there are hundreds of Dunkin' Donuts franchise owners who are today, fighting for their livelihood, trying to protect and defend their sweat equity built over many years, against a seemingly arrogant and intractable Dunkin' Brands Loss Prevention" with very deep pockets. I think that is unacceptable."

Eric Karp, Witmer, Karp, Warner & Ryan, representing the independent franchisee association avows that there is too much litigation going on in the donut system. He said they recently looked at the franchisor-initiated lawsuits from public records for 2007 and 2008 and it was quite revealing. "In each of those two fiscal years, Dunkin' filed more than 125 lawsuits against franchisees." In doing the math, Karp explained that means the company filed a lawsuit every six days over that two-year period.

Karp said now under the new franchise rule franchisors don't have to give the more detailed description that everyone is accustomed to seeing in the Item 3 litigation section of the disclosure documents. "They only have to give the kind of lawsuit it was, where it was filed and who the parties are." But he adds, "No matter how you look at it, it can't be good news for a franchisor to have this amount of litigation." Karp asks, "Is it cheaper to file a lawsuit in federal court than it is to help a franchisee get into compliance where they need assistance? This makes no sense to me, unless there is some ulterior motive at work."

But Karp feels the big issue is whether Dunkin' is misusing its superior financial resources against franchisees in the system to try to essentially reorient or redesign the entire system. And he feels that there is profit to be made. "Dunkin' is the full employment for franchisor lawyers. Can you imagine the legal fees that are being spent on these cases?" he asks. "So the lawyers are profiting and Dunkin' Donuts is profiting through the fines and penalties that they are extracting. And the small operators are taking it on the chin," he said.

In past years, Dunkin' has been accused of hardball tactics against small operators, terminating their contracts and turning their stores over to large multi-unit operators. When asked if Dunkin' is still aggressively trying to get rid of the small operators, Karp said, "It certainly seems that way to me."

Attorney Justin M. Klein, Marks & Klein, who represents several Dunkin' franchisees, believes Dunkin' uses its franchise agreement as a tool to gather information on particular franchise operators in an effort to create a default. "It may appear legitimate to default a franchisee who does not comply with the franchise agreement, but in matters I am familiar with it is more of a "ready, fire, aim" strategy. If Dunkin targets a franchisee, they will simultaneously default, terminate and file a lawsuit against the franchisee claiming alleged damage to the trademark." Klein said the franchisee is then put in a Hobson's Choice situation where they must either pay a substantial penalty to Dunkin' Donuts and exit the system, or hire a lawyer and pay tens of thousands of dollars to protect their investment. He adds, "Lawyers are expensive and you can only sell so many donuts in a day, thus for most franchisees in this situation, there is no real choice."

Robert Zarco, Zarco, Einhorn, Salkowski & Brito, affirmed that the franchisor is turning its lawsuits against franchisees into a major "profit center," and refers to it as a "management by fear" strategy. "I've had close to a dozen cases where a franchisee who complains about anything becomes a subject of a scrutiny or an audit by the franchisor." He said Dunkin's loss prevention department has been very aggressive in going after franchisees for infractions that include such things as violations of the Fair Labor Standards Act where the franchisee's employees are working more than 40 hours and not being paid overtime, or the employees are on the books as independent contractors and being issued 1099s when in reality they are employees. Another common one is writing off some personal expenses as business expenses.

Zarco said when shop owners complain to Dunkin' about something like encroachment issues on their stores, the company threatens to take action against them on some of these minor infractions. He said, "So it is used almost as leverage against the franchisee. They are scaring the franchise operator into submission to keep quiet." When a franchisee has 10 or 15 stores and a financial worth of \$5 to \$10 million, Zarco says the franchisee doesn't want to jeopardize his own company. His complaints for damages on a store being opened too close to his unit somehow pales in comparison with his losing his entire network.

Dunkin's director of public relations Michelle King issued this statement regarding the franchisor's litigation:

"Dunkin' Brands has never pursued litigation against a franchisee without clear cause, nor will we. When our Loss Prevention group researches an inquiry, it is done in the most thorough, professional, transparent and ethical manner that adheres to all legal guidelines. Additionally, we do not differentiate between small and large operator networks or discriminate in any manner. In fact, we have a liaison committee of franchisees that has complete, unfettered access to every investigation, including the right to look at every document and the right to ask questions of any Loss Prevention personnel and the Chief Legal Officer regarding the investigation and the decision to pursue any case.

It is irresponsible and incorrect to imply that litigation is in any way part of Dunkin' Donuts' strategy for profitability. In 2008, despite the economic down cycle, Dunkin' Donuts global system-wide sales were up 5% and we opened more than 1,300 new stores worldwide."

But in his letter to DDIFO members, Coen strongly encouraged Dunkin' Brands to take a step back and reconsider its policy of litigation and instead embrace its process of mediation to settle disputes with franchise owners. He said, "It is the right thing to do to grow the brand in an increasingly challenging and competitive environment. DDIFO is ready, willing and able to help see this process of mediation come to fruition."

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