

MARKETPLACE

Franchisee Lawsuit Seeks \$1 Billion From Southland Operator of 7-Eleven Stores Is Accused of Fraud, Breach of Contract

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Southland Corp., the beleaguered Dallas franchiser of 7-Eleven convenience stores, has yet another fight on its hands.

Nine individuals this week asked a federal court in Chicago to certify a class-action lawsuit — seeking more than \$1 billion — against Southland and its owners.

The suit alleges fraud, breach of contract and other misdeeds by the franchiser. It is potentially the largest in a flurry of legal battles between franchisees and Southland, which oversees more than 14,000 stores world-wide.

The franchiser was hit last August with a major franchisee suit in a California state court over alleged vendor kickbacks, "forced 24-hour operation" and other matters. Southland also faces a lawsuit by the owners of some of the eight franchises it moved to terminate in January for alleged price-gouging after the Los Angeles earthquake. The company denies wrongdoing in those disputes.

Now, the new Chicago plaintiffs claim to be acting on behalf of more than 2,000 current and former 7-Eleven franchisees in the U.S. According to the suit, Southland has hurt the chain by slashing advertising, remodeling and other support services since 1987. Robert A. Zarco, a Miami attorney, developed the suit.

Southland, which has been controlled by Japanese retailer Ito-Yokado Co. since 1991, issued a statement calling the suit "preposterous and unfounded." Clark J. Matthews, Southland's president and chief executive officer, said: "It's absolutely mind-boggling that anyone could conclude, after reviewing the facts, that Southland hasn't supported 7-Eleven franchisees."

David J. Kaufmann, a New York lawyer for Southland, called the allegations in the suit "false, reckless and outrageous" and said: "This suit smacks of attorney opportunism, which will be properly dealt with. It appears that Mr. Zarco whipped up franchisee interest in this suit, rather than the other way around." He added: "I find it stunning that for a purported class action, Mr. Zarco could come up with only nine named plaintiffs." (Mr. Zarco, who was said to be traveling, couldn't be reached for comment.)

Some lawyers with no connections to the case said the lawsuit may be a long

shot. Mario L. Herman, a franchisee attorney in Washington, said class actions against franchisers are generally difficult to get certified. Unlike shareholders, who all own identical securities, franchisees may have differing contracts, may have received different promises, and often operate under disparate circumstances.

The 7-Eleven chain includes more than 3,000 franchised units in the U.S., where Southland is the biggest operator of convenience stores. Franchisees operate 7-Eleven stores provided by Southland. The company serves as landlord and even keeps the books. In return, Southland collects a hefty share — sometimes as high as 58% — of each store's "gross profit," as defined by the chain. This is much more than most other franchisers get, but few others promise or provide so much service, franchising specialists say. The initial franchise fees are also comparatively low — one reason the chain often appeals to franchise buyers with little cash.

According to the Chicago suit, however, Southland has continued collecting its usual charges even after cutting back services to franchisees. The alleged cuts began after a \$4.9 billion leveraged buyout of Southland in 1987. Southland was "financially devastated" by the buyout, the suit says.

Burdened with debt, the company was no longer able to satisfy its obligations to franchisees, the suit charges. It says the franchiser slashed capital spending; for example, such spending fell 72% in 1988, the suit says. Also in 1988, the franchiser "ceased all advertising," the suit adds.

(The company says advertising stopped only for a short while. And it says capital-spending numbers aren't a fair measure of franchisee support. Indeed, it says it stopped building new stores in order to focus on supporting existing ones.)

The physical deterioration of their stores and the lack of advertising hurt franchisees, whose sales and profits fell, the suit says. Meanwhile, it says, Southland concealed its financial condition from franchisees, in part by making false and misleading statements.

About three years after the leveraged buyout, the company voluntarily sought

protection from creditors under Chapter 11 of the federal Bankruptcy Code. It emerged from court protection early in 1991. Central to the company's survival was the purchase of a controlling stake — now 64% — by companies owned by Ito-Yokado.

In alleging problems caused by a leveraged buyout, the Southland suit resembles a suit by a group of franchisees against Postal Instant Press Inc. in state court in California. (PIP denies wrongdoing.) The Southland suit is much more ambitious, however, seeking status as a class action on behalf of thousands, even though there are only nine plaintiffs.

In its statement, Southland said it has vigorously supported franchisees. The company said that throughout the buyout and subsequent events, it honored all contractual obligations to franchisees. The company added that during the last five years, it has provided franchisees with more than \$85 million of income and incentives "above and beyond that which we are obligated to provide."

Southland said it now ensures that some franchisees will earn a specified minimum gross income. The company said it also now gives \$1,000 a month in extra financial assistance to some stores.

Southland said franchisees' annual net income — routinely reported to the franchiser — was nearly 17% higher in 1993 than in 1987, when the alleged problems began. The company said 7-Eleven stores continue to outperform the industry average.

The company said it is in the midst of its most-extensive remodeling program ever. More than 1,500 stores have been remodeled since late 1992, with 1,000 more to be remodeled this year, it added. About half of the stores being remodeled are operated by franchisees, it said.