

REVIEW

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Miami lawyer Robert Zarco says a victory for his franchisee client will send repercussions throughout the fast-food business.

BUSINESS

Burger King faces franchise fight

Dispute over newer outlet could change industry practices

By ROBERT KUNTZ, Review Staff

The owner of a Burger King franchise, who already is suing the Dade-based chain for allowing another restaurant to be built near

his, now claims that corporate managers knew all along that he would be ruined, but lied about their intentions.

Steven A. Scheck, the owner of a Lee, Mass., Burger King, is asking a Miami judge to allow him to add allegations of fraud to his suit. If

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Scheck is successful at trial, franchise holders of all kinds may have new leverage to challenge the actions of their franchisers.

This case — viewed as a landmark-in-the-making — was brought by Scheck in 1989. He claims Burger King ruined his business by allowing another outlet to open two miles away.

The new restaurant — built on the leg of the Massachusetts Turnpike that had brought Scheck many of his customers — cost Scheck \$300,000 a year in sales, says his Miami lawyer, Robert Zarco.

Scheck originally alleged only breach of contract and breach of an implied covenant of good faith, saying Burger King wronged him by opening the second restaurant knowing it would "cannibalize" his business.

In the past, such suits involving the proximity of fast-food outlets typically have been dismissed short of trial. Franchise contracts used by Burger King and other fast-food companies make it clear that franchisees have no exclusive right to a territory. That clause has been interpreted by most judges to mean the franchisers could build or authorize construction of new restaurants as and where they pleased.

But in July, U.S. District Judge William M. Hoeverler denied Burger King's request to throw out Scheck's suit. Although he dismissed Scheck's allegation of a breach of an implied noncompete covenant, Hoeverler let stand the claim that Burger King breached an implied covenant of good faith and fair dealing. He took the unusual stance that a jury should be allowed to decide the case.

"This court will not blindly adopt the reasoning or analysis adopted by other courts...merely because the implied covenant of good faith and fair dealing involves an intricate and amorphous legal construct," Hoeverler wrote in a footnote to his decision. He

added that he declined to "jump on the precedential bandwagon."

Hoeverler ruled that "while Scheck is not entitled to an exclusive territory, he is entitled to expect that Burger King will not act to destroy the right of the franchisee to enjoy the fruits of the contract."

A Miami franchise lawyer calls the case a "landmark."

"I think it is a very significant case for many reasons," says Ronald Fieldstone of Fieldstone & Lester in Miami. "In fact, franchise attorneys consider this to be a landmark case in that it will for the first time clarify franchisers' duty to exercise good faith in opening company stores and other franchises."

Fieldstone — who is not involved in the case — says that in even those cases where contracts do provide some protected area, that area typically hasn't been large enough to protect the franchisee's business.

"That's why this is a major case," Fieldstone says. "If Scheck wins, this adds judicial clarification to the implied duty of good faith."

The trial was set to begin Dec. 7, but may be delayed if Hoeverler allows Scheck to amend his complaint to add the fraud count. Scheck contends that not only did Burger King open a restaurant that ruined Scheck's business, but the corporation lied to Scheck about its plans for the new restaurant.

Burger King has asked Hoeverler to deny the request to amend the complaint. The corporation says the fraud allegations are baseless and not timely filed. Michael Evans, Burger King spokesman would say only that "we deny the allegations and we intend to pursue a vigorous defense of our position."

The Hojo

Court documents show that as early as 1983, Scheck knew that Burger

King wanted to convert a Howard Johnson restaurant on the Massachusetts Turnpike into a Burger King. Scheck "strenuously objected," arguing that another Burger King so close by would hurt his business.

In summer 1985, Marriott Corp. announced that it planned to buy the Howard Johnson. That was good news for Scheck, because he believed the acquisition would put an end to plans for converting the site into a Burger King. Burger King has a policy that prohibits any franchise owner from owning a "same or similar" restaurant of another chain. Since Marriott owns Roy Rogers and Big Boy restaurants, Scheck concluded, Burger King would never allow Marriott to turn the site into a Burger King.

"Not only did Scheck believe that, he was told that repeatedly by Burger King officials," Zarco says. "He was told there was no way Marriott would be allowed to convert that to a Burger King."

In fall 1985, Scheck, who had been renting his restaurant from Burger King, agreed to buy the property outright. Scheck concluded the \$691,000 deal, Zarco says, only after he got additional assurances from Burger King that the turnpike site would not be converted. In spring 1986, Scheck spent another \$190,000 remodeling his restaurant.

Then, in fall 1986, the turnpike site was approved as a Marriot-owned Burger King.

Zarco says Scheck was told that decision wasn't made until nearly a year after Scheck bought his site. But once Scheck sued — and Burger King had to turn over hundreds of documents as part of the court-ordered discovery process — Scheck came to believe the conversion had always been planned and he'd been lied to.

"Scheck could not have, and in fact, did not discover the fraud until this lawsuit was initiated," Zarco

wrote in court papers. "Prior to the filing of this lawsuit, Scheck was completely unaware that the Lee turnpike site had always been slated for conversion and was unaffected by Marriott's acquisition of the [Howard Johnson]. Scheck had always assumed, as he was told, that [Burger King] had put the Lee turnpike site on hold and only after a year had passed since he purchased the property did [Burger King] change its mind and allow the site conversion to continue."

The usual deal

If Hoeveler allows the fraud allegation to be added to the complaint, the trial likely will be delayed a month or two to allow Burger King to prepare a defense. Scheck originally was seeking about \$2 million in compensatory damages. But if the fraud allegation is allowed, that will open the door to punitive damages "in the millions," Zarco says.

Beyond any damages Scheck may recover, Zarco says a victory for his

client will send repercussions throughout the fast-food industry, substantially changing the relationship between franchisers such as Burger King and their thousands of franchisees. Fieldstone agrees, saying a Scheck victory would "shake up" the industry.

What will change, the lawyers say, is the franchiser's ability to open new stores anywhere and any time they choose, virtually without regard to the effect on existing stores.

"I think the problem has to do with how the franchisers make their money," Zarco says. "They don't make money based on the profitability of each location, but based on gross sales and percentage rent. The fact is, McDonald's and Burger King are in the real estate business, not the hamburger business."

Barry Ziegler, a restaurant industry analyst for A.G. Edwards & Sons, says, "There's some truth to that view."

If Scheck prevails at trial, Zarco says, "in a post-Scheck era, franchisers are going to have to tread much more lightly before they encroach on an existing franchise."

And Ziegler says that could ultimately be good for Burger King. More heavily franchised than other fast-food chains, the company doesn't do itself any good by angering its franchisees, he says. Franchisees enable a company to expand quickly and open new stores. So if the parent companies are forced to look more carefully at encroachment, he says, it may be those parent companies that ultimately benefit.

"If you put in a store that hurt the profitability of another franchisee, that's bad for the company," Ziegler says. "Even though on paper it might look like they don't suffer, or even make more, the parent company can't afford to have bad relationships with its franchisees."

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