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Burger King franchisees sue over \$1 double cheeseburger

By Elaine Walker

Burger King's franchisees are taking their fight against the company over sandwich pricing to court.

The National Franchisee Association filed a suit this week in U.S. District Court in Miami against Burger King, arguing that the company does not have the authority, under the franchisees agreement, to “dictate maximum pricing.”

The motivation for the suit comes after Burger King forced all franchisees to sell its double cheeseburger for \$1, starting in October. Franchisees had twice during the summer voted against the \$1 double cheeseburger promotion.

The franchisee association, which represents more than 80 percent of U.S. Burger King franchisees, filed the lawsuit after unsuccessful attempts to negotiate with Burger King. They are asking the court to acknowledge that Burger King does not have the right to set prices and that power rests with the independent franchisees.

“Our franchisee community is united in protecting our entrepreneurial rights as independent business owners,” said William Harloe Jr., chairman of the NFA and a Maryland BK franchisee.

As of Thursday morning Burger King had not yet been served with the lawsuit, a company spokeswoman said.

During an earnings conference call last month, Chief Executive John Chidsey told analysts he was encouraged by the early results of the double cheeseburger promotion.

During an 18-month test, the \$1 double cheeseburger had a negative impact on gross profit margin, Burger King said, but restaurants saw an increased gross profit because consumers added on high profit items like sodas and french fries.

Franchisees argue that Burger King is using the promotion to boost sales to satisfy Wall Street investors at the expense of franchisees' profits. The company's most recent earnings report showed a 6 percent drop in profits, a 5 percent decline in revenue and a 4.6 percent fall in sales at stores open in North America more than a year.

Based on numbers Burger King provided to franchisees, the company projects that the double cheeseburger will lead to a 5 percent increase in restaurant sales. That will translate into an increased bottom line profit of \$365 per restaurant based on \$105,000 in sales, according to the analysis.

But financial models run by one Illinois franchisee and circulated among franchisees across the country suggest that those numbers are too optimistic and won't drive enough sales to offset the margin pressure. The franchisee models suggest that the bottom line impact for restaurants would be a loss of between \$489 and \$930 depending on the percentage of total sales generated by the value menu.

Stifel Nicolaus restaurant analyst Steve West agrees with franchisees that it is a dangerous move for Burger King.

“They're going to pressure margins and lower their average check,” said West, who in September downgraded Burger King's stock to a “hold” rating. “If you don't get enough sales, you're shooting yourself in the foot. History has shown that this doesn't work.”

Other analysts say that promotions have become the cost of doing business in an economic climate that has seen consumers cut back on eating out.

“I think the benefits outweigh the costs right now,” said Tom Forte, restaurant analyst with Telsey Advisory Group. “What's the alternative? Not discounting and losing traffic to the competition.”

At the end of last year, McDonald's stopped selling its double cheeseburger for \$1 because of profit margin concerns.