

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

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DISTRICT COURT
MIDDLETOWN CT

JEFFREY OFFUTT, AS A TRUSTEE
OF THE SUBWAY FRANCHISEE
ADVERTISING FUND TRUST

Plaintiff,

V.

DOCTOR'S ASSOCIATES, INC.

Defendant.

Civ. No.

307 CV 363 AWT

MARCH 7, 2007

COMPLAINT FOR DECLARATORY JUDGMENT AND OTHER RELIEF

Plaintiff Jeffrey Offutt, in his representative capacity as a duly authorized Trustee of the Subway Franchisee Advertising Fund Trust ("SFAFT"), brings this action for declaratory, injunctive, and other relief and alleges as follows:

INTRODUCTION

1. Plaintiff brings this action pursuant to the Declaratory Judgment Act, 28 U.S.C. §§2201 and 2202, to obtain (a) a declaratory judgment that the Subway Franchisee Advertising Fund Trust Agreement (the "Trust Agreement") requires Doctor's Associates, Inc. ("DAI"), the settlor of SFAFT and the franchisor of the Subway franchise system, to pay to SFAFT all advertising contributions made by Subway franchisees, and (b) an injunction prohibiting DAI from enforcing franchise agreement provisions that require franchisees to pay advertising contributions to any entity other than SFAFT. DAI's new form of Subway franchise agreement, which DAI began using for franchise sales in April 2006, provides that each Subway franchisee whose franchised business is subject to that agreement will pay advertising contributions to DAI, not to SFAFT. Millions of dollars in franchisee contributions are at issue. If this controversy is not resolved, SFAFT may be deprived of all or most of its funding, thereby thwarting the

unambiguous intent and purpose of the Trust Agreement, and preventing SFAFT from (a) performing the functions for which it was created, and (b) fulfilling its fiduciary obligations to its beneficiaries, the Subway franchisees.

PARTIES, JURISDICTION AND VENUE

2. Plaintiff Jeffrey Offutt (“Offutt”) is an individual and a resident of the State of Missouri.

3. Plaintiff Offutt also is a Trustee of SFAFT, and currently serves as Chairman of the Board of Directors of SFAFT. SFAFT’s Board of Directors voted to authorize the filing of this lawsuit, and authorized Plaintiff Offutt to prosecute the action on behalf of SFAFT in his capacity as Trustee. Accordingly, on behalf of SFAFT, Plaintiff Offutt seeks to have this Court declare the rights and legal obligations of SFAFT and DAI under the Trust Agreement.

4. Defendant DAI is a corporation organized under the laws of the State of Florida. DAI’s principal place of business is located at 325 Bic Drive, Milford, Connecticut.

5. This Court has original jurisdiction over this matter under 28 U.S.C. §1332 (a) because the matter in controversy exceeds the sum or value of \$75,000, exclusive of interests and costs, and is between citizens of different states. Plaintiff Offutt is a resident of the State of Missouri, and he is the real party in interest in his capacity as a Trustee of SFAFT. Defendant DAI is a Florida corporation with its principal place of business in Milford, Connecticut.

6. Venue is proper in this District under 28 U.S.C. §1391(a) because (a) DAI’s principal place of business is in Milford, Connecticut, (b) the Trust Agreement was entered into in, and is performed in, Milford, Connecticut, and (c) a substantial part of the events giving rise to the claims has occurred in Milford, Connecticut.

ADVERTISING CONTRIBUTIONS

7. Defendant DAI is the franchisor of the Subway franchise system. DAI has entered into separate, but similar, agreements with franchisees (hereinafter the “Franchise Agreements”). Each Franchise Agreement gives the franchisee the exclusive right to use the Subway and affiliated trademarks, trade names and service marks in the operation of a Subway Sandwich Shop business at a designated location, many of which are within the State of Connecticut.

8. Many Subway franchisees have more than one Subway Sandwich Shop business. A franchisee must enter into a separate Franchise Agreement for each Subway Sandwich Shop business that he or she operates.

9. Pursuant to the Franchise Agreements, Subway franchisees are required to pay an initial franchise fee to DAI, and to pay ongoing royalty payments to DAI, which are measured as a percentage of the gross sales of the franchisees’ Subway Sandwich Shop businesses.

10. The Franchise Agreements also require Subway franchisees to pay a percentage of their gross sales to an advertising fund, which, prior to the creation of SFAFT, was referred to as the Franchisee Advertising Fund. The purpose of the Franchisee Advertising Fund was, and the purpose of SFAFT is, to fund group advertising and promotion of the Subway Sandwich Shop business for the benefit of all Subway franchisees.

11. On November 14, 1990, DAI and the Board of Directors of the Franchisee Advertising Fund created SFAFT by entering into the Trust Agreement. SFAFT was intended to replace the Franchisee Advertising Fund. A true and correct copy of the Trust Agreement is attached hereto as Exhibit A and is incorporated herein by reference. The Trust Agreement was

made “by and between [DAI] . . . , as settlor, and the members of the Board of Directors of Subway Franchisee Advertising Fund, as it is constituted from time to time, as Trustees.” (Ex. A at p. 1).

12. The recitals to the Trust Agreement are expressly “made a part of th[e] Trust Agreement.” (Ex. A, § 1).

13. The third recital to the Trust Agreement provides: “the Settlor [*i.e.*, DAI] and the Board of Directors of the Franchisee Advertising Fund desire to establish this Trust to hold the assets of the Franchisee Advertising Fund and the Settlor and the Board of Directors desire that all amounts payable under the Franchise Agreements to the Franchisee Advertising Fund shall hereafter be paid to the Trust that is established hereunder.” (Ex. A, third recital).

14. The term “Franchisee Advertising Fund” is defined in the Trust Agreement to mean: “the fund established by the Settlor and the Franchisees to create advertising programs designed to build Subway Sandwich Shop sales and the chain’s identity, produce advertising materials for the use of Subway Sandwich Shop store owners, and pool resources to purchase media exposure.” (Ex. A, § 3).

15. The second recital to the Trust Agreement recognizes that “pursuant to the terms of the Franchise Agreements between the Settlor and the Franchisees, the Franchisees are required to pay a percentage of their gross sales to a Franchisee Advertising Fund for the purpose of funding group advertising and promotion of the Subway Sandwich Shop business for the benefit of all franchisees.” (Ex. A, second recital).

16. The Trust Agreement further provides: “the Settlor and Board of Directors of the Franchisee Advertising Fund desire to form this Trust to receive, invest, administer, disburse, and account for said advertising funds and other sums that may from time to time be allocated

for such purposes by the Settlor from its own funds, by any Franchisee or from any other source.” (Ex. A, fourth recital).

17. The Trust Agreement also provides: “the parties hereto do hereby establish the Subway Franchisee Advertising Trust and agree that the Trust shall be comprised, held and disposed of as [provided in the Trust Agreement].” (Ex. A at p. 1).

18. The Trust Agreement may be amended only by a majority vote of the Trustees, with the written consent of DAI. (Ex. A, § 12).

19. The Trust may be terminated only if DAI authorizes termination **and** 75% of the Trustees vote to approve termination. (Ex. A, § 6).

20. The Trust Agreement provides that it “shall be governed by and construed in accordance with the laws of the State of Connecticut . . .” (Ex. A, § 14).

21. Section 4.2 of the Trust Agreement provides: “the Settlor hereby agrees that it will take **all steps necessary** to cause **all payments** made by its Franchisees to the Franchisee Advertising Fund to be paid hereafter directly to the Trust.” (Ex. A, § 4.2 (emphasis added)).

22. Pursuant to § 9.6 of the Trust Agreement, the Trust agrees to defend and indemnify each Trustee of SFAFT against any claims brought against such Trustee in connection with his or her good faith execution of his or her duties as a Trustee of SFAFT, and § 9.8 provides, *inter alia*, that such indemnification may be secured by insurance paid for from SFAFT funds, subject to the provisions of §4.2.

23. The second sentence of § 4.2 provides that “(i) if [the Settlor] alters, modifies or cancels the provisions of its Franchise Agreement with its Franchisees (either now in existence or subsequently executed), and (ii) such action causes the payments by the Franchisees to the Trust to be reduced, encumbered or eliminated – thereafter, the Settlor will replace the Trust as

the indemnitor of the Trustees under Section 9.6 and 9.8 below, in respect of all actions taken by the Trustees prior thereto.” (Ex. A, § 4.2 (emphasis in original)).

24. Thus, § 4.2 provides that DAI must “take all steps necessary” to ensure that “all payments” made by Subway franchisees to the Franchisee Advertising Fund are paid to SFAFT, and that if DAI “alters, modifies or cancels” provisions of the Franchise Agreement so that “all payments” made by franchisees to SFAFT are reduced (for example, by reducing the contribution percentage from 4.2% to 1.5%) or eliminated (by eliminating the provision in the Franchise Agreement that requires the franchisees to make advertising fund contributions to SFAFT), so that SFAFT no longer has the funds needed to defend and indemnify its Trustees, DAI will defend and indemnify the Trustees. However, the Trust Agreement does not permit DAI to direct that “all payments” made by Subway franchisees as advertising contributions be paid to any entity other than SFAFT.

25. Prior to April 2006, the Franchise Agreement provided that “all payments” made by Subway franchisees as advertising contributions would be paid to SFAFT. For example, the 1996 Franchise Agreement provided: “The Franchisee agrees to: . . . i. pay into the Subway Franchisee Advertising Fund Trust two and one-half (2 ½%) per cent of the gross sales of his sandwich shop. The advertising percentage may be increased temporarily or permanently at any time by a two-thirds (2/3) vote of the total existing franchisees on the basis of one vote for each operating sandwich shop.” A copy of the 1996 Franchise Agreement is attached hereto as Exhibit B and is incorporated herein by reference.

26. In 1998, most of the Subway franchisees voted to increase the advertising fund contribution from 2.5% to 3.5% by signing an Advertising Fee Rider. A true and correct copy of the Advertising Fee Rider is attached hereto as Exhibit C and is incorporated herein by reference.

27. Pursuant to the Advertising Fee Rider, a franchisee who signed the Rider agreed “to approve a permanent 1% increase, from 2.5% to 3.5%, in the advertising percentage payable to the Subway Franchisee Advertising Fund Trust . . .” (Ex. C). More than ninety percent (90%) of the Subway franchisee local markets (*i.e.*, 226 out of 250 local markets) elected to approve the 1% increase in advertising contributions payable to SFAFT.

28. The Advertising Fee Rider further provided that “The Franchise Agreement, as amended and supplemented by this Rider, is ratified and affirmed.” (Ex. C). That is, each of the Franchise Agreements was amended to provide for a payment to SFAFT of an additional 1% of gross sales.

29. The franchisees approved an increase in the advertising contributions payable to SFAFT from 3.5% of sales to 4.5% of sales, as of September 2003.

30. DAI disclosed the franchisees’ obligation to pay their advertising contributions to SFAFT in DAI’s Uniform Franchise Offering Circular (“UFOC”). Pursuant to the Federal Trade Commission regulations entitled “Disclosure Requirements and Prohibitions concerning Franchising and Business Opportunity Ventures,” 16 C.F.R. § 436.1 *et seq.* (hereinafter referred to as the “FTC Franchise Rule”), as well as various state franchise disclosure statutes, DAI is required to provide a UFOC (which contains certain financial and other disclosures, including the amounts of any fees that a franchisee is required to pay pursuant to the Franchise Agreement) to each prospective franchisee before that person enters into a Franchise Agreement with DAI.

31. For many years prior to April 2006, each of the UFOCs issued by DAI provided as follows:

Note 2. *Advertising Programs.* . . . SFAFT administers the 3.5% advertising fee (or higher percentage voted by the franchisees) that franchisees pay under the Franchise Agreement. . . . SFAFT also administers the portion of vendor contributions we or our other

affiliates may negotiate with vendors and manufacturers and forward to SFAFT. . . . You will participate in the chainwide SFAFT and will be subject to the chainwide SFAFT's *Policies and Procedures Manual*. . . . The chainwide SFAFT Board sets policy governing how the advertising fee assessed by the Franchise Agreement and any vendor contributions and supplemental funds are allocated and spent and approves all chainwide promotions. The SFAFT Board of Trustees has decision making power over how SFAFT collects, budgets, and distributes the advertising fees and approves policies that govern the Trust's administration. . . . You must contribute the amounts described in Item 6, under the headings "Advertising", "Additional Funds" and "Local Advertising". . . . We do not have the sole power to dissolve SFAFT. If we authorize the termination of the trust, at least 75% of the Board of Trustees of SFAFT must also vote to approve the termination of the trust. . . . We do not have the power to change the SFAFT *Policy and Procedure Manual* or to require the formation, change, merger or dissolution of advertising cooperatives. . . . The chainwide SFAFT Board of Trustees approves an annual budget and makes all financial decisions for spending SFAFT's collections. . . .

32. Notwithstanding the unambiguous provisions of the Trust Agreement requiring DAI to "take all steps necessary" to ensure that Franchisees pay their advertising contributions to SFAFT, beginning in April 2006 DAI revised the form of Franchise Agreement that it offered to prospective franchisees beginning in April 2006, to require that Franchisees pay their advertising contributions to DAI – not to SFAFT.

33. Item 11 of DAI's UFOC dated April 1, 2006 provides (at p. 57):

Currently, advertising contributions are directed to the Subway Franchisee Advertising Fund Trust ("SFAFT") which provides advertising services to the restaurants that contribute to it. We may direct that advertising contributions be placed into another advertising [sic] as stated above. . . .

34. Section 5.i. of each DAI Franchise Agreement entered into beginning in April 2006 (hereinafter, the "2006 Franchise Agreement") provides:

You will pay us, three and one-half percent (3 1/2 %) of gross sales of the Restaurant on a weekly basis until the franchisees in your country approve a permanent increase of the advertising

percentage to four and one-half percent (4 1/2%) by a two thirds (2/3) vote on the basis of one (1) vote for each operating restaurant. This amount will be placed into an advertising fund managed jointly by us and elected franchisees for the benefit of franchisees in the System.

A copy of the 2006 Franchise Agreement is attached hereto as Exhibit D and is incorporated herein by reference.

35. In addition, the 2006 Franchise Agreement provides that if an existing Subway franchisee enters into a 2006 Franchise Agreement for a new Subway Sandwich Shop business, all of the existing Subway Sandwich Shop businesses owned by that franchisee will be subject to the terms of the 2006 Franchise Agreement. Recital K to DAI's UFOC dated April 1, 2006 provides:

“YOU UNDERSTAND AND ACKNOWLEDGE THAT PARAGRAPH 14 OF THIS AGREEMENT AMENDS ANY EXISTING FRANCHISE AGREEMENTS YOU HAVE WITH US, to include the following provisions of this Agreement: . . . Subparagraph 5.i. (regarding payment of advertising contributions . . .).” (Ex. D, ¶ 14(emphasis in original)).

36. Paragraph 14 of the 2006 Franchise Agreement provides:

“. . . You agree to accept the provisions set forth in . . . Subparagraph 5.i., . . . in this Agreement, for this Agreement and to the amendment of all your other existing Franchise Agreements with us to include these provisions (if the existing Franchise Agreements do not already include these provisions). EACH OF YOU SIGNING THIS AGREEMENT AS FRANCHISEE ACKNOWLEDGES AND UNDERSTANDS THAT THIS PARAGRAPH 14 AMENDS ALL YOUR EXISTING FRANCHISE AGREEMENTS WITH US, AND ANY SUCH AMENDMENT WILL SURVIVE THE TERMINATION OR EXPIRATION OF THIS AGREEMENT.” (emphasis in original)

37. Accordingly, any franchisee that (a) owns one or more existing Subway Sandwich Shop businesses and (b) signs a 2006 Franchise Agreement for a new Subway Sandwich Shop

business, is contractually required to pay 4 ½% of gross sales from **all** such existing Subway Sandwich Shop businesses to DAI, even though the franchisee previously paid such advertising contributions to SFAFT.

38. DAI's UFOC dated April 1, 2006 states:

Note 2. *Advertising Fees.* You will pay us 4.5% of gross sales of the Restaurant on a weekly basis. This amount will be placed into an advertising fund managed jointly by us and elected franchisees for the benefit of franchisees in the SUBWAY© system. . . .

COUNT ONE (DECLARATORY JUDGMENT)

39. Plaintiff incorporates the allegations in paragraphs 1-38 of this Complaint as if set forth fully herein.

40. As stated above, the recitals to the Trust Agreement unambiguously set forth the intent of the Settlor (*i.e.*, DAI) to establish SFAFT “to hold the assets of the Franchisee Advertising Fund” and to ensure that “all amounts payable under the Franchise Agreements to the Franchisee Advertising Fund shall hereinafter be paid to [SFAFT].” (Ex. A, recitals).

41. Section 4.2 of the Trust Agreement expressly provides that DAI “will take **all steps necessary** to cause **all payments** made by its Franchisees to the Franchisee Advertising Fund to be paid hereafter directly to the Trust.” (Ex. A, § 4.2 (emphasis added)).

42. In compliance with the Trust Agreement, from 1996 until April 2006 all of DAI's franchise agreements required Subway franchisees to pay all of their advertising contributions to SFAFT, and each of DAI's UFOCs disclosed that obligation.

43. However, § 5.i. of the 2006 Franchise Agreement requires that Subway franchisees pay their advertising contributions to DAI, in breach of the Trust Agreement. Moreover, § 14 of the 2006 Franchise Agreement, which all franchisees of new Subway Sandwich Shops must sign, amends **all** of the Franchise Agreements that a signing franchisee

executed before April 2006, thereby requiring that franchisee to pay 4 ½% of gross sales of those previously franchised Subway Sandwich Shop businesses to DAI, instead of to SFAFT, in further breach of the Trust Agreement.

44. The effect of §§ 5.i. and 14 of the 2006 Franchise Agreement will be to deprive SFAFT of its funding. If these provisions are not declared null and void and unenforceable, they eventually will cause a *de facto* termination of SFAFT, and will deprive SFAFT of its ability to fulfill its purpose and the Settlor's intent, as expressed unambiguously in the Trust Agreement.

45. DAI has made these unlawful changes to its 2006 Franchise Agreement in breach of the Trust Agreement.

46. By virtue of the foregoing, there are bona fide and substantial questions in dispute, and a substantial uncertainty of legal relations that require judicial determination and resolution.


PRAYER FOR RELIEF

WHEREFORE, Plaintiff Offutt, on behalf of SFAFT, respectfully requests that this Court grant the following relief:

- A. Declare that unless and until the Trust Agreement is terminated according to its terms, DAI must take all steps necessary to cause all franchisee advertising contributions to be paid directly to SFAFT.
- B. Declare that the portion of § 5.i. of the 2006 Franchise Agreement that requires Subway franchisees to pay any portion of their advertising contributions to any entity other than SFAFT is null and void and is unenforceable.
- C. Declare that the portion of § 14 of the 2006 Franchise Agreement that requires the franchisee to amend all of his or her existing Franchise Agreements to require that franchisee to pay advertising contributions to an entity other than SFAFT is null and void and is unenforceable.
- D. Enjoin DAI from enforcing § 5.i. of the 2006 Franchise Agreement requiring Subway franchisees to pay any portion of their advertising contributions to any entity other than SFAFT.
- E. Enjoin DAI from enforcing that portion of § 14 of the 2006 Franchise Agreement that incorporates new § 5.i. in each of the franchisee's existing Franchise Agreements and thereby requires the franchisee to pay advertising contributions to an entity other than SFAFT.
- F. Order DAI to take all appropriate steps necessary to amend § 5.i. of the 2006 Franchise Agreement immediately, and order DAI to take all appropriate steps necessary to amend each 2006 Franchise Agreement signed by any franchisee to comply with the Trust Agreement.

G. Such other and further relief as this Court deems just and equitable.

JEFFREY OFFUTT, AS A TRUSTEE OF THE SUBWAY
FRANCHISEE ADVERTISING FUND TRUST

By 
Jonathan B. Orleans (ct 05440)
Robert M. Frost, Jr. (ct 19771)

ZELDES, NEEDLE & COOPER
A Professional Corporation
1000 Lafayette Boulevard
Bridgeport, Connecticut 06604
Juris No: 69695
Tel: (203) 333-9441
Fax: (203) 333-1489
E-Mail: jorleans@znclaw.com
rfrost@znclaw.com

Their Attorneys

OF COUNSEL:

Lee N. Abrams, Esq.
Diane Green-Kelly, Esq.
MAYER, BROWN, ROWE & MAW LLP
71 South Wacker Drive
Chicago, IL 60606
Tel: (312) 782-0600
Fax: (312) 701-7711
E-Mail: labrams@mayerbrownrowe.com
dgreenkelly@mayerbrownrowe.com