National Coalition Condemns Heavy-Handed Tactics of Its Franchisor-Demands Good Faith Negotiations to Develop a Fair, Balanced and Equitable Renewal Agreement

December 31, 2017

On October 12, 2017, a 54 page class-action complaint was filed in the United States District Court for the Central District of California, Western Division, alleging that 7-Eleven, Inc. (SEI) is in violation of the Federal Labor Standards Act and California employment laws in connection with its administration of this convenience store system. The docket number is 2:17-CV-7454. The complaint seeks money damages, restitution and other relief.

The central basis of the complaint is that while SEI promises to treat franchisees as independent contractors, they in fact do the exact opposite, treating franchisees as employees. Over time, SEI has been gradually chipping away at the profits of franchisees, increasing their costs, exercising more and more control over what is supposed to be an independently operated convenience store, where franchisees actually control the manner and the means of the operation of the location.

After an unsuccessful attempt to slow the progress of the case down, SEI has responded to the complaint in court, but outside of the legal proceedings, it has also responded in two separate and highly problematical ways.

First, SEI suspended all communications and meetings with each of the franchisee organizations within the system, including the National Business Leadership Council, the CEO Roundtable, and the National Coalition. In response to this disappointing and petulant action by SEI, the National Coalition voted to urge its members to skip the upcoming February 2018 7-Eleven Experience.

Second, without consulting any of the long-standing franchisee organizations, SEI more recently organized and executed a series of so-called Town Hall Meetings, pointing out to the franchisees that 80% of all franchise agreements will expire between 2019 and 2024. SEI then laid out a series of heavy-handed ultimatums to franchisees as a way of trying to outflank the potential massive liability of the California lawsuit, leveraging the fact that some franchisees have franchise agreements with a 50-50 gross profit split and others have a graduated gross profit split (GGPS). The core of these ultimatums is that SEI will double down on the existing GGPS, which even in its current form is virtually unprecedented within convenience store franchising in particular, and franchising in general.

SEI's central message is that if you don't accept one of their hollow proposals, then you will eventually end up with a graduated gross profit split that is much worse for franchisees with gross profit of $500,000 or more than the one that is currently in operation and which has generated so much controversy and unhappiness because it does not incentivize growth. We are calling this ***GGPS on Steroids*** or "**GGP-SOS**".

Disturbingly but unsurprisingly, SEI has not been transparent in providing detailed analysis of the combined effects of **GGP-SOS**, the proposed flattening of the advertising fee to 1% across the board, increased renewal fees and the incremental expense to franchisees of the outsourcing of payroll (a replay of what happened with equipment maintenance—and franchisees don't need to be reminded of how <u>that</u> negatively affected their bottom line!). We know SEI has crunched these numbers, but as is typical for this franchisor, they are treating the results with the same degree of obsessive secrecy that they apply to their relationships with the supply chain.

SEI had repeatedly assured the members of the Franchise Agreement Committee that their objective in creating a new contract was to grow the pie for both franchisor and franchisee, and assuredly not to grab a larger slice of the pie for itself. Unfortunately, this proposal fails to keep that commitment, because it has materially negative effects for franchisees at all levels of gross profit.

However, here is our preliminary best analysis of the yearly net economic loss to franchisees with gross profit of $500,000 or more, based on the information provided so far, taking into account the change in the ad fee and cost of outside payroll processing:

Gross Profit	50/50 to **GGP-SOS**	Current GGPS to **GGP-SOS**
$500,000	$3,900	$3,400
$600,000	$11,400	$5,900
$700,000	$19,400	$8,900
$800,000	$27,900	$11,900
$900,000	$36,400	$14,400
$1 million	$43,900	$15,900

These numbers do not take into account the elevated labor and write-offs associated with fresh foods and hot foods. For more than two years, we have been requesting that SEI provide evidence that fresh foods and hot foods are good for the <u>bottom line</u>. As we all know, franchisees—just like SEI—live off the bottom line. We are still waiting.

These numbers also do not take into account the elevated renewal fees proposed by SEI. If you signed an agreement between 2004 and 2006, you have no renewal fee. If you signed the 2010 or later franchise agreement, your renewal fee is based on a graduated scale. SEI's new proposal fee would increase by $23,750 for a store with $500,000 of gross profit and by $13,750 for a store with $700,000 gross profit.

If you have a store with less than $500,000 of gross profit, **GGP-SOS** contains a modest break by giving those franchisees a slightly higher share of gross profit. However this modest benefit is at least partially offset by an increase in advertising fees to 1% (franchisees gross with profit of less than $300,000 currently pay 1/2 of 1%), the cost of outsourced payroll and elimination of both the Assured Gross Income Support and Gross Income Support programs. Thus, the claimed benefits to lower volume stores are largely illusory.

If You Have a 2004 Agreement

For the limited number of franchisees that have a 50-50 gross profit split, SEI is basically giving you a five-year extension, no rights to renew thereafter, during which you must exit the system by selling your store or selling it back to SEI for an amount which they are predictably keeping secret. Alternatively, you must sign a 15 year agreement, converting to the current GGPS until 2030 (which presumably means until December 31, 2029), or for approximately 11.5 years starting next spring, following which you will be subject to the elevated **GGP-SOS** rolled out at the Town Hall Meetings.

If You Have a 2006 or 2010 Franchise Agreement

These franchisees have the option to sign a 15 year 2019 agreement and remain on the current GGPS until 2030, but only if they lock in **GGP-SOS,** which will become effective after December 31, 2029.

Other Representations by SEI

SEI apparently claimed in these Town Hall Meetings that it invests 90% of its earnings back into the system. Where is the proof for this representation? SEI has spent, and has plans to spend, billions of dollars on acquisitions, chiefly of gasoline assets. And many of the so-called investments are those which primarily benefit SEI, such as the DVR system. For years, the National Coalition has tried to get SEI to disclose how much money it has spent and how much money it will commit to spending on the remodeling, refurbishing, and updating of franchise locations. What does SEI have to hide?

SEI also announced that the 2019 agreement will drop the minimum Net Worth requirement for a store from $15,000 to $10,000 for a franchisee's first store and to $5,000 for each additional store. While it might seem that this proposal would free up more dollars for franchisee draw, it actually has the apparent purpose of masking troubling trends in store level profitability. According to the Audited Financial Statements of SEI, the gross margin achieved by SEI franchised locations throughout the United States fell from 36.24% in 2012 to 36.06% in 2013, to 35.8% in 2014, to 35.68% in 2015. The gross margin performance of company stores also declined from 31.48% in 2012 to 28.87% in 2016. Moreover, based upon disclosures of SEI's publicly held parent company, the gross profit margin of all U.S. stores fell from 34.9% for the six months ended June 30, 2016 to 34.4% for the six months ended June 30, 2017.

Analysis

What these proposals have in common is that they give all existing franchisees the right to extend whatever their current gross profit split is until December 31, 2029. There is some very limited and modest relief for low volume stores. SEI intends to roll these proposals out in the spring of 2018 and induce franchisees, out of fear of the consequences of **GGP-SOS,** to sign up thereafter. Of course, what SEI is most after is securing each franchisee's signature on a release of claims which will reduce the potential damages in the California lawsuit or in any lawsuit that might be brought in any other state on the same basis.

We have two major responses to SEI:

First, ***please come clean*** and give every franchisee in the system a detailed analysis of how all of the moving parts in this proposal will affect their overall bottom line. This includes not only the effects of **GGP-SOS** whenever it kicks in, but also all the other financial changes as outlined above. What are the incremental costs of fresh foods and hot foods? How much capital will SEI commit to improving franchised stores? Only with that detailed analysis can any franchisee make an intelligent decision about what to do next.

Second, to the extent that SEI is forgoing its apparent plan to otherwise implement **GGP-SOS** on an ongoing basis, except to the extent of newly developed stores which will be subject to **GGP-SOS** from the outset, this does represent SEI's attempt to create the appearance of a financial concession by SEI for the limited period of time between now and December 31, 2029. The problem is that SEI steadfastly, indeed stubbornly refuses to sit down with elected franchisee representatives and hammer out a logical, fair, and balanced renewal franchise agreement.

In other words, this is SEI's opening bid; do not succumb to these scare tactics. Your franchisee leaders are working hard to get a better deal. Please support your FOAs and when SEI comes calling, don't accept their platitudes, just demand that they answer our questions and come to the bargaining table.

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