

## Cold Stone Creamery and Its Franchisees Take Joint Action Against Negative Publicity: A Behind-the-Scenes Look

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A strong brand can be a franchise system's most valuable asset. A strong brand may allow franchisors to maintain existing market share in the face of new competition and expand by attracting new, dedicated and qualified franchisees believing and wanting to invest in the strength of that brand. It allows franchisees to draw customers to their small businesses – sometimes even if they are the concept's first franchisee in the market. And it allows customers to know exactly what their experience will be before they step foot into the franchisee's store. A strong brand is a shared asset playing a key role in the prosperity and stability of franchisor and franchisee alike.

While some challenges to a franchise system take years to develop – such as a change in the public's taste or technological innovation – others, such as a food poisoning event or some kind of rumor, can be sudden and devastating. When a sudden challenge arises, careful consideration and concerted action are necessary to protect the brand. As Cold Stone Creamery recently learned, the likelihood of a successful resolution can be increased when a franchisor works with its franchisee community in evaluating and responding to the challenge. This article provides a behind-the-scenes look at how Cold Stone Creamery and its franchisees did just that in response to CNBC's *Behind the Counter: The Untold Story of Franchising*.

### *The Untold Story of Franchising*

CNBC broadcast an hour-long show entitled *Behind the Counter: The Untold Story of Franchising* in December 2010. The show was promoted as “an inside look at a trillion dollar industry” and was comprised of five different segments, each purporting to highlight a different franchisor, in conjunction with a different aspect of franchising:

- The Five Guys Burgers and Fries segment reported on the rapid expansion of the franchise and the attendant supply-chain logistical challenges.

- The Camp Bow Wow segment focused on Franchise Disclosure Document (FDD) Item 19 disclosures.
- The Proctor & Gamble segment focused on the substantial research and development that had been invested in dry cleaning and car wash franchise opportunities.
- The segment on Dunkin' Donuts featured the growth of minority-owned franchises and multigenerational-owned franchises.

In contrast to the other largely positive segments, the segment featuring Cold Stone was only negative. Throughout the broadcast, CNBC used the upcoming Cold Stone segment as a teaser by referring to “melted fortunes” and promising to reveal “the cold, hard facts about who's scooping up most of the profits.” The press release described that the segment “uncovers how a well-known franchise like Cold Stone Creamery may not be what it seems. With little protection or support from the Federal Trade Commission, along with hidden expenses, steep nonrefundable fees and more, even some of the most successful franchisees can't get out of the red.”

CNBC had contacted Cold Stone prior to the broadcast for an opportunity to comment, but did so only after contacting a former franchisee who CNBC relied upon in connection with the story. Cold Stone believed that its story should not be told by any one franchisee and was concerned about this particular former franchisee, who had been (and continues to be) engaged in an online smear campaign and had been in litigation with Cold Stone which focused in part on the effect of vendor rebates on the franchise system. Cold Stone believed that this franchisee's story would not accurately reflect the franchisee community as a whole.

Cold Stone sent CNBC the legal documents and court rulings related to the litigation between Cold Stone and the former franchisee. Cold Stone invited CNBC to review the documents in the hope that CNBC would reconsider the point of view of its only source.

The Cold Stone segment focused on vendor rebates and various other business practices that are disclosed in the Cold Stone FDD. The segment implied that Cold Stone was the only franchisor to accept vendor rebates and to charge franchisees for additional products and services. Although vendor rebates are a common practice in franchising and several of the other franchisors highlighted in the CNBC story either receive vendor rebates or retain the right to do so, the segment alleged the “cold reality is that Cold Stone relies on . . . kickbacks.”. CNBC reported that, “most [franchisees] share [the] belief that it’s too hard to make a buck under the system set up by Cold Stone’s holding company, Kahala” and that “franchisees feel the deck is stacked against them from the start.”. The segment claimed that, as a result, the business model is a failure and franchisees cannot profitably operate a Cold Stone. Cold Stone believed the segment also included other inaccuracies. CNBC reported that Cold Stone forces franchisees to buy unnecessary equipment and generates profits by subleasing store locations to franchisees. Further, CNBC reported that there was a yet-to-be-filed class action lawsuit to “help hundreds of former franchisees recover their lost money.”

#### **A Cold Reception**

The public reaction was immediate. The complaints streaming into Cold Stone in the hours and days following the initial broadcast included:

*I am a lover of Cold Stone Creamery and friends have even given me gift cards for my birthday. BUT I will no longer enter a Cold Stone Creamery store. How can you be such a parasite of the franchisers [sic] who are the ones who work hard to bring you the money!!!!!! SHAME ON YOU!*

And

*I LOVE your product, but after viewing the CNBC special about how you abuse your franchise owners, I regretfully will not entered [sic] one of your stores again. I can only hope enough people saw the CNBC special and avoid purchasing your product. Perhaps you need to rethink your business plan, and support your distribution partners.*

And

*The segment on Cold Stone was extremely surprising and frankly bitterly disheartening. In the past, it has been a favorite stop for my family after church service. I feel like I have somehow contributed to the suffering of their franchise owners. In good conscience, we know we cannot go back. We’ve already told our kids and*

*although they are young, they completely understand and agree with our decision . . . I’m disgusted in what I learned about Cold Stone. I just always thought it was a wholesome brand. I now know better. It’s a shame what they are doing to tear families apart. Those five people who wanted to commit suicide were deeply loved by family and friends, yet all Cold Stone could talk about was their legal victories. That could easily have been my family and it’s disappointing to hear that they are so very insensitive.*

Cold Stone and many of its franchisees were very concerned. Some customers were so incensed that they were willing to boycott their local franchisees’ stores in an attempt to “send a message” to Cold Stone. Then, it got worse. CNBC announced its intention to re-air the story five times in the ten days leading up to Christmas. CNBC also informed Cold Stone that the story would be broadcast several more times in 2011. This was a perfect storm for Cold Stone and its franchisees – not only would families be home and watching television – but it was the middle of winter when Cold Stone franchisees sell less ice cream.

#### **Getting Out From Behind the Counter**

Cold Stone believed that it had to respond quickly. Cold Stone retained outside counsel to assist in crafting a strategy to respond to the show. An initial letter dated December 18, 2010, sent to CNBC demanding a retraction and a shelving of the story met with little success. Rather, CNBC indicated that it believed its story was supporting Cold Stone’s franchisees and said it looked forward to deposing franchisees should the matter become contested.

However, Cold Stone’s franchisees were also feeling the sting of the public reaction to CNBC’s story. Cold Stone realized that a united front with its franchisees may be a more successful approach to CNBC. Cold Stone took the somewhat radical step of contacting Robert Zarco, a well-known franchisee attorney. Mr. Zarco had previously represented Cold Stone franchisees and area developers against Cold Stone and was already working with the newly formed National Independent Association of Cold Stone Creamery Franchisees (“NIACCF”). In agreeing to work with Cold Stone on this matter, Mr. Zarco made clear that his ultimate allegiance would always remain with the franchisees in the event of a dispute. Nevertheless, he believed that his involvement was important, because (in his words), “the brand itself, in which thousands of franchisees are deeply invested, is entitled to be protected from the sort of irresponsible reporting made manifest in CNBC’s television program. The focus of my efforts is to protect the brand. If those who profess that their goal is to destroy and decimate the brand itself through misinformation

succeed, this would be nothing short of a Pyrrhic victory putting everyone, but most importantly the franchisees, out of business.” Cold Stone ultimately offered to fund Mr. Zarco’s representation of both the NIACCF and the Cold Stone National Advisory Board (“NAB”). As Daniel Beem, Cold Stone Brand President, explains:

Cold Stone supports its franchisees and we wanted them to have the best possible counsel to aggressively and competently represent their interests. While Cold Stone may not always see “eye-to-eye” with every position taken by Mr. Zarco, we recognize and respect his judgment and legal abilities as among the best in his field. Cold Stone’s decision to pay Mr. Zarco to represent our franchisees is consistent with our longstanding goal to promote, protect, and expand the Cold Stone brand.

Cold Stone believed it was necessary to let CNBC know that its story was hurting, not helping, the franchisees and to let franchisees know that the franchisor was willing to stand up for them. As Mr. Zarco explains, “in my opinion, it is a deadly poison to the well-being of franchisees everywhere to take the position that franchisors and franchisees can never, ever work together under any circumstances. That is simply counter-productive, and against the best interests of the franchisees and the brand.”

Cold Stone and its franchisees began to analyze their options to respond to the CNBC show. Although Cold Stone had already sent a cease-and-desist letter to CNBC explaining the multiple inaccuracies, CNBC made only minor changes. CNBC had posted a “correction” on its webpage acknowledging that the former franchisee was not an attorney from Florida. It also made additional changes to its webpage regarding the story including changing:

Rovell also uncovers how a well-known franchise like Cold Stone Creamery may not be what it seems. With little protection or support from the Federal Trade Commission, along with hidden expenses, steep nonrefundable franchise fees and more, even some of the most successful franchisees can’t get out of the red.

to

Rovell also uncovers why owning a well-known franchise like Cold Stone Creamery may be more challenging than it appears at first.

In addition, CNBC made minor changes to the subsequent broadcasts. In the initial broadcast on December 15, CNBC reported only that Cold Stone had prevailed on its claim against the former franchisee. In the December 19 broadcast,

CNBC explained that not only had Cold Stone prevailed on its claim, but that Cold Stone had defeated the claims brought by the former franchisee.

The newly-formed team decided Mr. Zarco should send a similar cease-and-desist letter to CNBC on behalf of the franchisees on December 23, 2010. This letter met with better results, and CNBC agreed to pull the story and consider real changes to it.

Cold Stone believed the allegations that there are “hidden fees,” that Cold Stone profited from subleasing locations to franchisees, and that Cold Stone forced franchisees to buy unnecessary equipment were defamatory and false. Cold Stone also believed that the allegation that there was a “yet-to-be-filed class action” was false.

Cold Stone and the franchisees compiled supporting evidence and sent several more letters to CNBC. At this point, CNBC began to engage Cold Stone and the franchisees in a true discussion about many of the different aspects of being a Cold Stone franchisee.

Although Cold Stone and the franchisee community were pleased with the small changes made to each subsequent broadcast, the story remained inaccurate because, in Cold Stone’s and the franchisees’ view, it did not capture the experience of being a current Cold Stone franchisee.

On Christmas Eve (nine days after the initial broadcast and one day after the letter from Mr. Zarco), CNBC advised Cold Stone that it would stop broadcasting the show altogether. CNBC invited Cold Stone and its current franchisees to set the record straight and hopefully win back their customers.

### **Setting the Record Straight**

In early January 2011, Cold Stone Brand President Daniel Beem, Cold Stone franchisee Rudy Puig, and Robert Zarco sat for an interview with CNBC at CNBC’s headquarters in New York.

The interviewees used the opportunity to talk face-to-face with CNBC reporter Darren Rovell and explain why the original broadcast had caused so much harm. They also spent a substantial portion of the interview educating CNBC about standard practice in the franchise industry. They explained that vendor rebates are a common practice in franchising. Rudy Puig explained that Cold Stone’s suggested cost structure was achievable and that the deck was not “stacked against” the franchisees. Cold Stone explained that the vendor rebates it receives are reinvested for the benefit of the franchisees in the form of direct contributions to marketing, product innovation, technology, social media and subsidies for other products.

The interviewees further explained that a key aspect of franchising is that franchisees are independent small business owners. As a result, profitability is directly correlated to how each franchisee runs his or her business, and high gross revenue does not guarantee a profit because franchisees have tremendous discretion in how they run their businesses and control their costs. Cold Stone highlighted that forty percent of all store transfers are to existing franchisees – demonstrating that successful existing franchisees know how to run the business and continue to believe in the brand.

### **CNBC Makes Changes After Meeting With Cold Stone and Its Franchisees**

After the interview, CNBC rewrote the story. The new story was substantially more balanced.

While CNBC continued to focus on vendor rebates, this time, CNBC interviewed a franchise attorney who confirmed what Cold Stone had said – that vendor rebates are common in the industry. The segment no longer suggested that rebates preclude franchisee profitability.

While CNBC did interview a small handful of additional former franchisees who supported the viewpoints expressed in the original broadcast, CNBC fairly represented facts particular to each franchisee. Although one franchisee alleged he was unable to make a profit as a result of the rebates, he also acknowledged that he was never able to achieve the suggested cost structure that other profitable franchisees were able to obtain. Another former franchisee said “all the costs were not what they were projected to be,” but also admitted she chose not to read the FDD in its entirety.

Cold Stone and its franchisees were happy with the new CNBC story. CNBC had given Cold Stone and the franchisees an opportunity to be heard and had taken their points of view into consideration.

Cold Stone and its franchisees understand that there is a natural tension in the franchise relationship, but also understand that the franchisor and its franchisees must be able to work together to respond to outside challenges to the brand. As Cold Stone franchisee Rudy Puig said:

Any entity or person that is hurting our brand right now is hurting our existing business. The franchisees love the brand. They love the ice cream. We love our customers. We are in the business of making people happy.

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*David Rauch and Michael J. Coccaro of Snell Wilmer L.L.P. represented Cold Stone Creamery in the dealings with CNBC, as described in this article.*



David Rauch is based in Snell & Wilmer's Phoenix office where he serves as the Chair of the firm's Franchise Litigation Group, and Co-Chair of the firm's Franchise and Retail Services Group. He handles complex business litigation of all kinds, with an emphasis on representing franchisors in disputes with franchisees and in other business disputes.



Mike Coccaro practices commercial litigation in the firm's Phoenix office. He has experience in franchise litigation, primarily focusing on representation of franchisors in dispute with franchisees. Mike has also represented national banks in litigation involving mortgage-related issues and a wide range of federal and state law issues. His experience also includes probate litigation and various business disputes.



Michael Reagan is the Executive Vice-President and General Counsel of Kahala, one of the world's largest multi-brand quick service restaurant franchisors. In this role, Mr. Reagan oversees all of the legal and real estate affairs for the company and its 3,500 units worldwide. Since joining Kahala in 2000, Mr. Reagan has been a part of the executive team that helped grow the company from 80 units to its current size and raised more than \$150M in private financing. In addition to his experience as a franchisor, Mr. Reagan also has 10 years of experience as a franchisee of a sign and graphic franchise, and is considered a true franchise expert.

Prior to joining Kahala, Mr. Reagan was a commercial transaction attorney at Ryley, Carlock & Applewhite, a Phoenix-based law firm serving Fortune 1000 clients, and a staff accountant at Deloitte & Touche, LLP, serving Arizona-based Fortune 500 clients.

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