

# United States Senate

May 21, 2019

COMMITTEES:  
FINANCE  
BANKING, HOUSING, AND  
URBAN AFFAIRS  
ENERGY AND NATURAL RESOURCES  
INDIAN AFFAIRS  
RULES AND ADMINISTRATION

Mr. Chris Pilkerton  
Acting Administrator  
U.S. Small Business Administration  
409 3<sup>rd</sup> Street, SW  
Washington, DC 20416

Dear Acting Administrator Pilkerton:

I write to request information regarding Small Business Administration (SBA) guaranteed loans to four franchises. In recent months, my staff have heard about problems with Complete Nutrition, Dickey's Barbecue, Experimac and Subway from franchisee owners who have SBA-guaranteed loans and are having trouble with the franchisor. These problems reported by Nevada business owners are similar to that of other franchisees across the nation:

- **Complete Nutrition.** Franchisees with SBA-guaranteed loans told us that Complete Nutrition had made it very difficult for them to be profitable by raising the price they paid for goods, restricting access to certain products to earn higher franchise payments, prohibiting internet advertising and harvesting customers' data from the store and then marketing to the customer directly via email offering discounts that the franchisee could not match and taking away other services from franchisees that were providing them revenue. In March, Complete Nutrition told its franchisees it would no longer be a franchise and the individual stores would become independent. The franchisees were also required to make a payment to become independent. In April of this year, Complete Nutrition eliminated franchisees' access to the point-of-sale system, removed franchisees' locations from its website and sent an email to the customers of the individual stores telling them that their stores had been sold and that customers should order online. A few days later, Complete Nutrition sent an apology email to all the customers of its stores saying the email was sent in error. Complete Nutrition leadership has not responded to numerous requests for information from my office. From our research, it appears as many as 66 Complete Nutrition franchise stores which provide nutrition, health supplements, and other related beauty products have SBA loans. Some data shows at least 12% percent of the loans have been charged off.
- **Dickey's Barbecue.** Press reports find that Dickey's Barbecue franchises are closing at an alarming rate, including two in my state over the past few years.<sup>1</sup> According to Dickey's Barbecue Franchise Disclosure Document (FDD) dated September 4, 2018, for the fiscal year ended May 1, 2018, the brand opened 72 new franchised units, but had 89

<sup>1</sup> Maze, Jonathan. "Dickey's Barbecue Pit Closes 113 Units." September 14, 2018. *Restaurant Business*. Available at: <https://www.restaurantbusinessonline.com/financing/dickeys-barbecue-closes-113-units-franchisees-bolt>

terminations and 24 ceased operations, for a net store loss of 41 units.<sup>2</sup> They ended the year with 521 units. An additional 44 units transferred to new owners. The previous year showed 88 units opened, 70 ceased operations, and 67 transfers. It appears that some of the loan failures may be due to Dickey's Barbecue providing misleading and inaccurate information to potential franchisees, resulting in failed businesses and bankrupt owners.<sup>3</sup> It appears Dickey's Barbecue was telling franchisees to expect revenue of up to \$80,000 per month but stores earned much less than that.<sup>4</sup> Last year, at my request, your staff provided default data to my office that showed taxpayer-guaranteed loans to Dickey's Barbecue franchisees failing at a higher rate than is typical for fast-casual restaurants. It appears that a change in ownership at Dickey's Barbecue has dramatically raised costs for the franchisee.

- **Experimac.** Between January 2010 and September 2018, SBA recorded 63 loans to Experimac franchisees. A number of these franchisees feel the estimated revenue provided by Experimac was inaccurate and that they have never earned the revenue reported as typical. Experimac required unusually high initial payments of \$49,500 per franchisee. Experimac also required franchisees spend \$130,000 to design the store and buy the supplies. SBA guaranteed 63 loans to Experimac franchisees, of which 86% were made by Celtic Bank. Celtic Bank quickly sold them to investors. To date, at least 23% of these loans have failed. All the charged off loans, and nearly all the loans (54 loans or 86% of all loans) were financed by Celtic Bank Corporation, based out of Salt Lake City, Utah. In addition, Experimac was sued by Apple for patent violations, i.e. "Mac" without telling franchisees of the lawsuit threat.
- **Subway.** Subway franchisees across the nation are struggling to survive with expensive promotional offers and corporate decisions that undermine the franchisees' survival. A recent story noted that nearly 3% of SBA guaranteed loans for Subway franchisees have been charged off. Subway is accused by its franchisees of using minor infractions to steal the stores from owners through a rigged arbitration system.<sup>5</sup>

I would like to inform my constituents of the resources SBA can provide to help them avoid default. I would also like to ensure other franchisees do not receive government-guaranteed loans

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<sup>2</sup> Dickey's Barbecue Restaurants, Inc. (2018)." Franchise Disclosure Document (Rep. No. 620051)." *Wisconsin Department of Financial Institutions*. Accessed May 20, 2019. Available at: <https://www.wdfi.org/apps/FranchiseSearch/details.aspx?id=620051&hash=1542075382&search=external&type=GENERAL>

<sup>3</sup> Miller, Keith. "Can Dickey's BBQ Franchise Owners Survive? Franchisees Claim They Received Misleading Numbers." *Blue MauMau*. October 1, 2018. Available at: <https://www.bluemaumau.org/blog/2018/10/01/can-dickeys-bbq-franchise-owners-survive-franchisees-claim-they-received-misleading>

<sup>4</sup> *Ibid.*

<sup>5</sup> Kosman, Josh. "Subway's arbitration for minor infractions is out of control: franchisees." *New York Post*. May 5, 2019. Retrieved from: <https://nypost.com/2019/05/05/subways-arbitration-for-minor-infractions-is-out-of-control-franchisees/>

for franchises with a history of complaints about unfair and deceptive practices. Therefore, I request the following information:

- 1) How is the SBA working with franchisees with SBA loans when a franchisee runs into trouble?
  - a. Specifically, when the SBA notices high rates of defaults in a franchise, what action does your staff take to prevent loan failures?
  - b. If there is a major change in an agreement, like those that occurred with Complete Nutrition, Subway or Dickey's Barbecue, what recourse does the SBA have to prevent loan failures?
  - c. How does SBA review ownership changes and what can SBA do when such changes have the potential to harm the revenue of franchisees with existing SBA loans?
  - d. Regarding Complete Nutrition, what can SBA do when a franchisor terminates the franchise agreement entirely? Does Complete Nutrition have affiliated brands seeking SBA-guaranteed loans? If so, what are the other brands?
  - e. Are there examples of other SBA-guaranteed franchisors making similar decisions as the one Complete Nutrition made to stop being a franchise? If so, how were the franchisees compensated? Did the franchisor make payments on outstanding loans of the franchisees?
  - f. Can the SBA exclude a brand if there are significant problems with one of the franchises in its portfolio? Has the SBA stopped loan guarantees to one brand because of problems in a franchise within its portfolio? If so, which franchise brands and franchise owners and when?
- 2) How many total loans did SBA make to the four mentioned franchises over the past six years -- 2013-2019? Please break out the loans by year and state.
- 3) How many of the four franchises have loans that defaulted? How soon after the loan closed were those loans charged off? Please break out this information by year and state.
- 4) How many of the four franchises mentioned are behind in their loans but are not listed as defaulting yet? How soon after the loan closed were those loans charged off? Please break out this information by year and state.
- 5) What information on revenue, defaults and store closings does the SBA require franchisors to provide to franchisees seeking SBA-guaranteed financing? Is that information provided within the Financial Disclosure Document?

According to a 2018 report from the International Franchise Association (IFA), Nevada is predicted to have the fastest franchise growth in the nation.<sup>6</sup> While many of my constituents are successful franchise owners, I am troubled by increasing complaints from entrepreneurs about

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<sup>6</sup> IHS Markit Economics. "Franchise Business Economic Outlook for 2018." *International Franchise Association*. January 2018. Available at: [https://franchiseeconomy.com/files/Franchise\\_Business\\_Outlook\\_Jan\\_2018.pdf](https://franchiseeconomy.com/files/Franchise_Business_Outlook_Jan_2018.pdf)

unfair practices that are causing them financial difficulties. Please respond to this request by June 21, 2019. For more information please contact Carol Wayman on my staff at 202.224.3150 or Carol\_Wayman@cortezmasto.senate.gov.

Sincerely,



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Catherine Cortez Masto  
United States Senator

CC: United States Senate Small Business Committee Chairman, the Honorable Marco Rubio  
United States Senate Small Business Committee Ranking Member, the Honorable Ben Cardin