



NEWS ALERT

February 25, 2005

This is the third in a series of four News Alerts.

Decisions taken by IDQ in 2003 and 2004 have placed at risk certain of the rights that DQ franchisees' have. These risks create current "global issues". These "global issues" are summarized from IDQ's bulletins, FAC meetings, the "Concept Evolution" memo and the November 2004 Uniform Franchise Offering Circular (as amended at the conclusion of the DQ Grill & Chill "test" and filed with the appropriate governmental agencies). This UFOC is provided to prospective DQ Grill & Chill franchisees as well as to Brazier operators who are converting to Grill & Chill.

1. **Issue:** Encroachment- Although it is correct that the current encroachment bulletin was authored by Harris Cooper in the early 1970's, that bulletin has no place in the current franchising environment at IDQ. Times have changed, and a DQ Grill & Chill located in close proximity to a DQ, DQ Limited or DQ Brazier can do substantial damage to the sales and profitability of an existing DQ franchisee. Query? If you were investing \$1.5 to \$2 million in a new DQ Grill & Chill, would you feel comfortable with a "site location only" to protect your investment? We don't think so.

Suggestion: The DQQA has suggested many ways for dealing with the encroachment issue. IDQ has rejected the approaches that are articulated in the current encroachment policies of other competitors.

Our most recent suggestion was that IDQ notify the nearest franchisee(s) about a proposed new location. If the nearby franchisee(s) do not have any issues with the placement of the prospective new location, all would be well. If the existing franchisee(s) object to the new location, IDQ and the objecting franchisee(s) would jointly commission and pay for an independent "pin or impact study", of the type utilized by many companies in the retail business to predict damage to existing stores and the viability of new stores. If this independent study showed potential damage of 10% or more to the store sales of the existing franchisee, the new unit would not go forward, and therefore all would be well.

IDQ rejected this suggestion.

2. **Issue:** Franchise Expiration- It is clear that IDQ cannot meet its current goal of two (2) systems in a 10 year period without stopping renewals of existing agreements as they expire. Of course, if you are willing to sign a new Grill & Chill franchise agreement and go forward as a Grill & Chill "image only" with an investment of \$400,000 or more, you have that option.

Suggestion: DQQA has suggested that the renewal program be similar to the new Pizza Hut arrangement. This arrangement addresses franchisee investment by rewarding X dollars of investment with a 10 year renewal, X+Y 20 years and the "full boat" with a 30 year franchise agreement.

Pizza Hut negotiated the new franchise agreement with the Pizza Hut franchisee association and the franchisees. This is a step toward "trust" and "unity".

IDQ has rejected this suggestion.

3. **Issue:** Sale and Transfer- The current sale and transfer policy is unfair. The required "test" is faulty, the cash requirement is unrealistic and the guarantee is unreasonable, to name a few issues.

These concerns were discussed with Mr. Mooty at a 2004 FAC meeting. Mr. Mooty agreed that the test needed fine tuning, and that the cash requirements for a sale to a current DQ store manager are unreasonable. Mr. Mooty, has had more than six months to readjust these requirements, but he has not done so.

Trust?

4. **Issue:** Non System Food- IDQ has declared a ten (10) year goal of having two systems: The DQ Grill & Chill system for food, and the “DQ Treatworks” system for DQ/Orange Julius/Hot Dog and snacks. IDQ says that non system food stores –whether they serve flavored soft serve or hot dogs or a full food menu which has been allowed in most instances for over 20-30-40 years -- must go.

Fair? We don't think so.

In 1985, a DQ franchisee brought suit against IDQ/ADQ in the Federal District Court in Fort Wayne, Indiana to prevent the removal of certain food items that had been allowed for over 20 years. The judge ruled in the franchisee's favor, stating: “Failure to object to a licensee's sale of unauthorized products for more than 25 years waived a licensor's contractual right to prohibit the sale of products, other than soft serve ice cream, without written consent. A contractual provision may be impliedly waived by the knowing and willing acquiescence of the party for whose benefit the provision was inserted. For 18 years, the licensor's predecessor had full knowledge of sales of other products and did not object. For an additional seven years, the licensor made no comment about the sales of other products. Thus, the licensor, and particularly its predecessor, waived any right to approve or disapprove the sale of food items in the licensee's store. Such waiver cannot be recalled or expunged.”

IDQ's plan currently is to pick off these approximately 600 stores one at a time until few are left, and then mandate the remaining few out. Why? So that IDQ can avoid a “class action” or collaborative suit by these franchisees.

“Fair? Trust?” The DQOA/DQOC is currently considering funding litigation on this issue. We'll keep you advised.

5. **Issue:** Single sourcing of products, goods, and services to the franchisees. Your DQOA/DQOC fought through six years of litigation to protect your rights to source your products, goods, and services competitively. This has provided savings in excess of 16% to all DQ franchisees. IDQ originally stated, in the DQ Grill & Chill Amendment for DQ Brazier franchisees converting to Grill & Chill, that the franchisees would have to give up their hard fought rights and agree to single sourcing. This issue became a DQOA “public issue” within the DQ system. In the current amendment, the single sourcing provision has been removed. However, new Grill & Chill franchisees and Treatworks franchisees agree to single sourcing in their franchise agreements. IDQ has stated that the Class Settlement Agreement will apply only to existing franchisees and not to new franchisees.

We disagree, and we will contest this issue vigorously

6. **Issue:** Pride- We are in favor of Pride. We are against the inconsistency of the Pride inspection from IDQ field representative to field representative. More than six months ago, IDQ stated that it was working on this problem. The problem still remains.
7. **Issue:** Record Keeping/Audit- The current requirements in this regard are fine for a \$2,000,000 store. For the mom and pop, they are abusive.
8. **Issue:** Oreo Whole and Oreo Crushed Cookies- During the 2004 arbitration brought by the DQOA/DQOC to compel IDQ to sell crushed Oreo cookies to DQOC warehouses per the Collins Settlement, IDQ differentiated between the “branded” Oreo cookie (which IDQ can single source) and the crushed Oreo. The arbitrator ruled in favor of the DQOA/DQOC. The DQOA/DQOC then requested that IDQ comply and sell the crushed Oreo cookie to DQOC warehouses at the same price that it sells to IDQ warehouses. IDQ replied that “the ‘crushed Oreo’ product is not covered by the Class Settlement Agreement” in the Collins case,” and that IDQ is changing its method of doing its supply chain business from “Buy and Sell” to getting paid by the vendor for “management services” or “no services”- see the UFOC.

The DQOA/DQOC has asked IDQ if IDQ is going to continue to honor the Class Settlement Agreement. We have not had a response to date.

“Trust”

9. **Issue:** Chili Hot Dog Sauce With Meat- The following letter from the DQOA to IDQ says it all.

February 4, 2005

O. Michael Rinke
Vice President and Assistant General Counsel
American Dairy Queen Corp.
7505 Metro Boulevard
P.O. Box 390286
Minneapolis, MN 55439

Re: Chili Hot Dog Sauce with Meat

Dear Mr. Rinke:

I am writing regarding the DQOC's attempts to obtain approval of an alternative supplier of Chili Hot Dog Sauce with Meat. In light of what has occurred, which we discuss below, we request that IDQ sell that product directly to DQOC-endorsed warehouses at the same price and on the same terms that IDQ offers to its authorized warehouses, until IDQ approves Whiteford Foods as a supplier of approved Chili Hot Dog Sauce with Meat.

As you are aware, Whiteford Foods has submitted nineteen samples over the course of the past 2 1/2 years. By itself, that fact raises a question as to whether IDQ is implementing the product approval process fairly. Whiteford Foods is a very competent manufacturer that has worked (and continues to work) diligently to obtain IDQ approval of approved Chili Hot Dog Sauce with Meat. However, the facts demonstrate that IDQ has unfairly imposed tougher standards on Whiteford Foods than IDQ has imposed on its own suppliers.

On August 24, 2004, IDQ granted preliminary approval of a sample of Chili Hot Dog Sauce with Meat that Whiteford Foods submitted. Even though IDQ approved that sample, it refused to approve the label because the declaration of ingredients did not match IDQ's specifications. Apparently, Whiteford Foods' label had two ingredients not listed on the IDQ-approved label specification: sodium phosphate and flavoring. How can a sample of sauce meet specifications for taste, consistency, etc., while the declaration of ingredients does not, unless IDQ's label specification is incorrect?

The USDA refused to approve the label submitted by Whiteford Foods because that label described the product as "Chili Hot Dog Sauce." It was only after that rejection by the USDA that we learned that IDQ's manufacturer uses the description "Chili Hot Dog Sauce with Meat." IDQ's failure to inform Whiteford Foods of that difference unreasonably delayed the approval process. We have reason to believe that the Chili Hot Dog Sauce with Meat that IDQ's suppliers produce do not meet IDQ's specifications, yet those suppliers continue to supply the Dairy Queen system, while Whiteford Foods has been barred from doing so.

In addition to the foregoing, IDQ has refused to approve the numerous samples of Chili Hot Dog Sauce with Meat that Suzanna's Kitchen has submitted for approval. Suzanna's Kitchen, which has supplied certain Dairy Queen franchisees for quite some time, has lost interest in continuing to work toward approval because IDQ's specifications cannot reasonably be met.

Whiteford Foods is willing to continue to work towards obtaining IDQ approval of its Chili Hot Dog Sauce with Meat. However, in light of the problems that Whiteford Foods has experienced, due to no fault of its own, the DQOC requests that IDQ sell approved Chili Hot Dog Sauce with Meat directly to DQOC-endorsed warehouses at the same price and on the same terms that IDQ offers to IDQ-authorized warehouses, until IDQ approves Whiteford Foods' Chili Hot Dog Sauce with Meat.

To the extent that IDQ contends that it no longer takes title to approved products and services, the DQOC requests that IDQ instruct its Chili Hot Dog Sauce suppliers to sell to DQOC-endorsed

warehouses at the same price and on the same terms that IDQ has negotiated with those suppliers to sell to IDQ-authorized warehouses.

Sincerely,
Harris Cooper
Executive Director

“Trust”

10. **Issue:** Misrepresentation of the cost to modify to Grill & Chill image only- The November/December 2004 World of DQ contained an article stating that this modernization could be done for \$240,000. Recently a franchisee relying on this article did an image only change- it cost about \$385,000. When the author was asked about this difference, he was told that the author did not have all the costs at the time the article was written. IDQ was asked to print an apology and retraction. IDQ said that it would investigate. No response to date.

“Trust?”

IDQ knows the cost. Who’s kidding who?

These are the “current global issues”

The DQOA/DQOC directors reviewed these issues and Mr. Gainor's Unification Proposal. The following letter was then mailed to Mr. Gainor.

January 4, 2005

John Gainor, Executive Vice President Supply Chain
USCI - International Dairy Queen
7505 Metro Blvd.
PO Box 390286
Minneapolis, MN 55439-0286

Dear Mr. Gainor,

The DQOA/DQOC directors will consider your proposal of December 22, 2004.

However, I must advise you that the current “global issues” that exist between the U.S. Dairy Queen franchisees (except Texas) and IDQ/ADQ will have to be addressed first. The directors will confer with our legal advisors regarding these “global issues”, and then will communicate with Mr. Mooty. In the judgment of the DQOA/DQOC directors, it would not be in the best interest of the DQ franchisees whom we represent to endeavor to reach an agreement on your proposal without resolving the “global issues” first.

Thank you in advance for your patience.

Sincerely,
Harris Cooper
Executive Director

More to follow in the next News Alert