



*You should have in your files most of the materials referred to in this News Alert. DQOA members may receive a set of these documents by contacting the DQOA office at 952-556-5511.*

## **WHAT MR. MOOTY TOLD YOU AND THE ASSOCIATED PRESS IS NOT ACCURATE**

There have been so many ADQ bulletins, corporate letters, official pronouncements by corporate officers and volumes of financial data published about *Grill and Chill* and Concept Evolution, that we don't blame Mr. Mooty for giving a misleading description of Concept Evolution to the Associated Press and to the franchisees of this system.

Mr. Mooty presented 3 significant statements of fact to the Associated Press, namely,

1. Conversion to *Grill and Chill* and *Treatworks* is not required.
2. The maximum investment for any franchisee is only \$75,000 in 2008, \$85,000 in 2009 or \$95,000 in 2010.
3. *Grill and Chill* restaurants have "performed well".

Let's take a closer look at each of these points to see whether Mr. Mooty might have distorted reality a bit.

### **CONVERSION TO GRILL AND CHILL IS NOT REQUIRED**

**(Since *Treatworks* is still in test, we will limit our analysis to *Grill and Chill* only)**

The Chuck Chapman, February 18, 2004 Concept Evolution system memo clearly defined the future of ALL food stores. There is no gray area here, you will ALL become *Grill and Chill* design only or design/menu restaurants. This transition to *Grill and Chill* includes "new builds, refranchise, replacement locations, relocations, conversions and facility upgrades." A key word used in this memo is MODERNIZATIONS. Mr. Chapman defined modernization as "INCREMENTAL REMODELING TOWARD GRILL AND CHILL IMAGE". Chapman further stated

that “MODERNIZATION can be defined as incremental remodeling toward the evolution objective”. (Remember, the evolution objective is *Grill and Chill* or *Treatworks*, nothing else.) (More on modernization later.) If you had any doubts about ADQ’s intentions to convert you to *Grill and Chill*, please refer to page 9 of the Chapman memo; “Please note that ADQ does need to reserve its right to enforce the remodeling or MODERNIZATION (emphasis added) requirements that exist in various franchise agreements. ADQ may in the future implement a MODERNIZATION program based on these requirements.” There’s no gray area here either. MODERNIZATION = INCREMENTAL REMODELING TOWARD *GRILL AND CHILL*.

Three months after the Chapman memo, the Eric Lavanger May 1, 2004 memo, MODERNIZATION PROGRAM, was disseminated to the system. “...the MODERNIZATION PROGRAM is designed for franchisees that are desirous of improving their facilities by undertaking a series of facility remodels over time (remember this phrase “over time”) toward a *DQ Grill and Chill* image facility...” To reiterate, MODERNIZATION = INCREMENTAL REMODELING TOWARD *GRILL AND CHILL*. MODERNIZATION at this point was still voluntary.

On May 1, 2004 another Lavanger memo was sent to the system covering Replacement, Relocation and Conversion. Simply said, if you needed to replace or relocate your existing Brazier, your only option is *Grill and Chill*. By the way, Mr. Lavanger also stated that “ADQ cannot represent or guarantee that any particular store will achieve any particular level of sales or profits” (more on the success of *Grill and Chill* later).

December 1, 2004, Chuck Chapman sent a memo concluding the Project Octane Test. It’s official, *Grill and Chill* is your only option. Once again we are reminded that MODERNIZATIONS are intended to result in *Grill and Chill* conversions. Chapman states; “During the test, we have seen some great successes and we have made mistakes.” (More on the success of *Grill and Chill* later.)

On May 6, 2005 and June 1, 2005, Mr. Lavanger again referred to the *DQ Grill and Chill* MODERNIZATION PROGRAM. Here is the first instance in 18 months of memos wherein we are specifically told the MODERNIZATION PROGRAM is optional. However, there’s a caveat. Anything that you try to modernize in your store must be done in accordance with a *Grill and Chill* spec. Your only other option is to replace old outdated fixtures in your store with the same outdated item, just newer. You either change to *Grill and Chill* or you keep your blue wallpaper and pink formica counters forever. (But *Grill and Chill* is voluntary!)

On September 1, 2005, Troy Bader reinforced the MODERNIZATION message included in the Lavanger memos. “Specifically, licensees who wish to make improvements to an existing facility can either: (1) repair or replace elements of the

facility to PRESERVE, BUT NOT CHANGE, (emphasis added) the existing design and décor characteristics of the facility; or (2) begin moving the facility toward *DQ Grill and Chill...*” Updating your restaurant within reasonable budgetary limits is not allowed. You go *Grill and Chill* or you do not update your restaurant. (But *Grill and Chill*, of course, is voluntary.)

Eric Lavanger published another memo on April 1, 2006, offering various remodeling options, including a MODERNIZATION PROGRAM, all designed, of course, to lead to conversion to *Grill and Chill*. Again, we are reminded that the program is optional, unless, of course, you want to do more than just replace your old wallpaper. That triggers a *Grill and Chill* MODERNIZATION. The following very interesting sentence appeared in this Lavanger memo: “Given the scope and anticipated consumer impact of AlaCarte, Foundation Program and individual Modernization Program projects it is not anticipated that these programs will generate a significant return on investment.” (That’s very comforting.) MODERNIZATION and converting to *Grill and Chill* are used interchangeably in this memo.

Mr. Lavanger wrote to the system again on April 1, 2007 to discuss various remodeling programs leading to conversion to *Grill and Chill*. This memo stated that the Base remodel is similar to the \$200K basic remodel. Why is this pertinent? Well, the base remodel included exactly every component of the MODERNIZATION PROGRAM that Troy Bader announced in his June 15, 2007 system memo. Why did Mr. Mooty state that franchisees would only have to spend \$75,000?

Now comes the Troy Bader MODERNIZATION PROGRAM memo of June 15, 2007. Up to this point, if you believed that you were not required to MODERNIZE toward a *Grill and Chill*, this memo should have eliminated any doubts.

Remember, the MODERNIZATION PROGRAM was clearly spelled out in all the previous memos as “INCREMENTAL REMODELING TOWARD *GRILL AND CHILL* IMAGE”. Mr. Bader’s memo stated “...we also know that there will be a number of franchisees that will not choose to reinvest in their facilities on a voluntary basis.” “To help address this situation, we have developed the MODERNIZATION Program that is described in this bulletin.” (Notice that it is not voluntary anymore.) To further clarify where MODERNIZATION will take you, Mr. Bader stated that it will “move the restaurant closer to the THEN CURRENT STANDARDS FOR NEW RESTAURANTS of the type you are operating (e.g. food-centric or treat-centric...)” No secret here, the current standard is *Grill and Chill*.

So, do you still think conversion to *Grill and Chill* is voluntary? Here is a summary of various scenarios in which you will be REQUIRED TO MODERNIZE:

1. 36% of direct licensed franchisees will be required to MODERNIZE on a transfer/periodic basis.
2. Another 38% of direct licensed franchisees have franchise agreements that require modernization on transfer only.

3. Any franchisee who desires to improve his store by doing more than replacing old wallpaper or table tops must modernize.
4. Any franchisee who wants to expand his business by building a new store must modernize.
5. Any franchisee who must relocate his business for any reason must modernize.
6. Any franchisee whose building is destroyed by fire or other natural causes must modernize.
7. Any franchisee who has an expiring contract must modernize.

If after reading all of the above, you're still feeling safe from the ADQ Modernize to *Grill and Chill* program, here's an example of what Mr. Zucco is trying to do to a certain franchisee (name and location shall remain confidential):

The franchise agreement in question dates back to 1951. The agreement contains a clause referring to maintenance of the facility which states franchisee shall paint such building at least annually and to make any reasonable improvements requested by franchisor within a period of 30 days following such request. Mr. Zucco interpreted that maintenance clause to mean MODERNIZATION and told the franchisee that he would have to MODERNIZE upon transfer or by 2011. None of these conditions are stated in the franchise agreement. Remember, this agreement dates back to 1951. Still think you're safe?

Since 2004, all of the ADQ bulletins related to Concept Evolution clearly associated Modernization with incremental remodeling toward *Grill and Chill*. THE MANDATORY PATH TOWARD *GRILL AND CHILL* IS VERY CLEAR:

1. MODERNIZATION is incremental remodeling toward *Grill and Chill* image.
2. MODERNIZATION is required in all but the rarest of circumstances.

Now let's talk about how much it's going to cost you to MODERNIZE:

**THE MAXIMUM INVESTMENT FOR ANY FRANCHISEE IS ONLY  
\$75,000 IN 2008, \$85,000 IN 2009 OR \$95,000 IN 2010**

Mr. Mooty proclaimed to the Associated Press and the franchisee community that only those dollar expenditures would be required of franchisees. Mr. Mooty conveniently forgot to mention that this is just the first installment toward conversion to *Grill and Chill*. Let's recap the facts:

1. *Grill and Chill* is the only future option for the DQ food system.
2. All bulletins state clearly that Modernization is a path to *Grill and Chill* conversion.
3. The Facility MODERNIZATION Draft which accompanied the Troy Bader June 15, 2007 memo matches exactly the requirements of the \$200K base remodel toward *Grill and Chill*.
4. Periodic MODERNIZATIONS will be required to bring your restaurant to “THEN CURRENT STANDARDS” (read *Grill and Chill*).
5. 7 to 10 years after your initial investment of \$75,000 you will be required to spend additional money to continue the conversion.

The DQOA, in a letter dated March 30, 2007 to Troy Bader, asked “Seven years later when franchisees will be required to modernize again to meet “then current standards,” what can they expect”? “Can a store completely remodel from Brazier to a *Grill and Chill* for \$75,000?” Mr. Bader’s response was filled with the same half truths as Mr. Mooty’s statement. “The maximum required investment amount will be established on a rolling three year basis so that franchisees will always know what the requirement is as they look out over the upcoming few years” (very comforting). Mr. Bader then said something very odd; “Again the MODERNIZATION program does not require a franchisee to convert his or her restaurant to a *DQ Grill and Chill* restaurant.” Mr. Bader is apparently not reading his own memos, as well as those of Chuck Chapman and Eric Lavanger. What about MODERNIZATION as “INCREMENTAL REMODELING TOWARD *GRILL AND CHILL*?” What about THEN CURRENT STANDARDS? What about your FACILITY MODERNIZATION DRAFT matching exactly the \$200K base remodel toward conversion to *Grill and Chill*?

Half truths by Mr. Bader and Mr. Mooty are not acceptable to the franchisee community. Mr. Mooty might be able to mislead the Associated Press, but not the franchisees.

Let’s recap what all the ADQ memos have told us so far about the path toward *Grill and Chill*:

1. MODERNIZATION is the “incremental remodeling toward *Grill and Chill* image.
2. MODERNIZATION is REQUIRED in all but the rarest of circumstances.
3. \$75,000 is just the first installment toward full conversion to *Grill and Chill*.

4. ADQ will let you know what your next installment will cost 3 years before that installment is REQUIRED.
5. Every 7-10 years (remember the words “over time” in Lavanger’s memo of May 1, 2004) you will MODERNIZE TO THEN CURRENT STANDARDS until you are a full blown *Grill and Chill*.

If you doubt any of this, and still believe Mr. Mooty when he tells the Associated Press that you are not required to convert to *Grill and Chill*, READ THE BULLETINS.

**MR. MOOTY SAYS THAT GRILL AND CHILL RESTAURANTS HAVE  
“PERFORMED WELL”**

Let’s take a look at the 2007 Uniform Franchise Offering Circular in which ADQ is required by law to disclose certain financial data about its *Grill and Chill* restaurants. Any franchisee can find this information by referring to Exhibit 17, Earnings Claim in the UFOC.

Here are certain financial data that should cause you a great deal of concern: (the data covers 42 *Grill and Chills* with full year sales).

1. ADQ shows the “WEIGHTED AVERAGE” sales to be \$1,266,000.
2. The “REAL” average sales for these restaurants is only \$1,145,000.
3. Only 14 *Grill and Chills* reached \$1.2 million in sales. That’s 33%. 67% did not even reach what ADQ calls the WEIGHTED AVERAGE.
4. The Food Cost numbers that ADQ discloses do not include discounts given and employee meals. These are buried in “Local Advertising” and no number for local advertising is disclosed.
5. Manageable Profit averages 28% for all 42 stores, which sounds quite good, until you read “WARNING F”: “The expenses identified in the statements included in Schedule A are not the only expenses that you will incur in connection with your operation of your *DQ Grill and Chill* Restaurant. You may incur other additional expenses including, but not limited to, insurance, legal and accounting, interest on debt service, rent (if applicable), depreciation/amortization, property taxes, and other taxes and licenses. You and your advisors should consider this in your due diligence and preparation of your business plan”. Do you know what ADQ has cleverly forgotten to include in warning F? ROYALTY AND ADVERTISING!! (Take off another 10%.)

6. Let's assume you do \$1.2 million in sales. (Remember, you only have a 33% chance of doing that!) Let's also assume that you have \$1.6 million invested in your *Grill and Chill*. (This is a very conservative number. Your investment will more than likely be \$1.8-\$2.0 million or more.)

Take ADQ's number of 28% manageable profit, subtract debt service on \$1.6 million, throw in all the other expenses that you MAY incur and you barely break even. For example:

Assuming Sales of	\$1,200,000
Manage Profit	336,000 (28%)
P & I Annual	<148,848>
Royalty 4%	<48,000>
Adver. 6%	<72,000>
Insurance	< 8,000>
Legal	< 2,000>
Accounting	< 6,000>
Prop. Tax	<20,000>
Other tax/lic.	< 2,000>
Payroll Process	< 2,500>

Leaving CASH FLOW of \$26,652

7. The scenario for remodels is also rather unsettling. ADQ discloses in Schedule B of the UFOC that 14 stores spent an average of \$480,000 on full remodeling to a *Grill and Chill* design or design/menu. Of those 14 stores, when you consider debt service against the profit resulting from the sales increase achieved, 6 stores lost money or broke even (This assumes 35% bottom line profit on increased sales and debt service of 15 years at 7%).

From ADQ's own published discounts show that investing in a *Grill and Chill* is a gamble and that the *Grill and Chill* Restaurants as a group are hardly "performing well".

**THE FRANCHISEES OF THIS SYSTEM ARE FACING THE LOSS OF THE DAIRY QUEEN BRAND BY THE MANDATED CHANGE TO TWO UNPROVEN CONCEPTS, DQ GRILL AND CHILL AND DQ TREATWORKS. A PERMANENT INJUNCTION BY THE FEDERAL DISTRICT COURT IN MICHIGAN AGAINST MANDATING EITHER OF THESE UNPROVEN CONCEPTS IS NECESSARY TO PRESERVE THE EQUITY THAT THOUSANDS OF FRANCHISEES HAVE INVESTED IN THE DAIRY QUEEN BRAND. WE HOPE THAT THIS DOCUMENT HAS SHED SOME LIGHT ON WHY THE LITIGATION IS NECESSARY.**

## **IS IDQ/ADQ REQUIRING YOU TO CHANGE NOW?**

The state associations of Arizona, Northeastern Store Owners, Heartland and Southeastern Store Owners have joined the Michigan Dairy Queen Operators' Association in a lawsuit in the Western District of Michigan Federal Court to resolve whether IDQ/ADQ can force/mandate franchisees to modernize/convert their franchise outlets into the new brand concept of *Grill and Chill*. Unfortunately, as in most lawsuits, results do not usually come quickly.

We have been told that while the lawsuit proceeds, IDQ/ADQ continues to force its modernization/conversion programs onto its franchisees. This creates serious confusion for you as a franchisee who would like to know the resolution of this lawsuit before complying with these forced modernization/conversion programs. This is especially frustrating if IDQ/ADQ is requiring you to take certain steps NOW (or in the very near future) to modernize/convert or take any steps towards changing your franchised outlet into the *Grill and Chill* concept before this lawsuit is resolved. If you would prefer to wait until the court resolves the case, please contact:

DQOA

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