

Judge Allows Racketeering Claims against Moe's Southwest

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ATLANTA — A district judge has ruled that franchisees may use [racketeering](#) claims against Moe's Southwest Grill and its founder in trial. In the lawsuit, franchisees allege that the franchisor has been stealing money from them through a convoluted deceptive kickback scheme connected to its supply chain.

The judge had to dismiss certain franchisees and their claims against Moe's and its holding company [Raving Brands](#) because of the time limits required in bringing their complaints. But the court did not reject the remaining owners' allegations of fraud and other claims, including damages.

Attorney Robert Einhorn of Zarco Einhorn Salkowski & Brito, representing the store operators, explains the litigation: "This is just another example of greedy franchisors using the supply chain as a vehicle to earn hidden royalties. We are pleased that the court is recognizing in general that if the franchisor does proceed to earn money off the supply chain and doesn't disclose it, there could be potential liability for fraud and RICO [Racketeer Influenced and Corrupt Organizations Act]."



A sign on a Moe's Southwest Grill restaurant in Utah. photo/bmm

The anatomy of a kickback scheme



Martin Sprock

H. Martin Sprock III started his [Moe's Southwest Grill](#) chain in July 2000, as part of his multi-concept company, Raving Brands. When the self-proclaimed former ski bum began franchising Moe's in 2001, he grew the Mexican fast-casual brand from 17 restaurants to 343 by 2007.

In selling food and other products to franchise owners, Sprock hired Tony LaGratta, an expert in the industry. Since 1996, LaGratta worked for Chain Reaction Marketing, a third-party food-supply and distribution brokerage company. Sprock saw LaGratta's dual-employment role as a plus for his new Mexican restaurant chain. While Sprock hired him to serve as food-supply manager of Planet Smoothie, another Raving Brand-owned concept, LaGratta immediately set up a complex supply chain distribution program to make additional money off the backs of Moe's franchisees.

LaGratta's first initiative was to enlist Chain Reaction Marketing (CRM) to serve as Moe's Southwest Grill's food distributor in selling products to its franchisees. As CRM's food supply manager, LaGratta approached the owner Steven Salzburg with his plan. Because of his established relationship with LaGratta, Salzburg agreed to help create and run Moe's food-supply chain, even though its volume was below CRM standards.

In order to implement the food supply program, LaGratta also brought in another food distributor, International Jobbers (IJ), to take the orders from Moe's franchisees. For that service, IJ charged store owners 2% on all orders of products and supplies. To fund the 2% fee, International Jobbers charged franchisees a "[margin on sell](#)" percentage of 10.5% instead of 8.5%.

This arrangement between CRM and Moe's Southwest chain provided LaGratta with half of whatever funds CRM received from any of Moe's food suppliers, including International Jobbers. Sprock, as CEO of the Mexican chain, knew about the arrangement and approved it.

LaGratta then created the entity SOS Foodservice Consultants on August 28, 2002, to house the CRM-LaGratta operating agreement. As parties to SOS, CRM and LaGratta shared equally all profits above any expenses. That included \$150,000 salary to LaGratta from the supply chain operation. LaGratta agreed to pay Sprock 50% of his profits after expenses.

That supply chain arrangement was not disclosed to potential buyers in Moe's first Uniform Franchise Offering Circular (UFOC) in 2001. That triggered the litigation.

At the heart of the lawsuit is the allegation that Moe's did not reveal in its 2001 disclosure document to prospective franchisees that Sprock held a significant interest in Moe's designated supplier, SOS

Foodservice Consultants. But the franchisor maintains that Sprock did not have a financial interest in SOS until after it was formed in August 2002. Because LaGratta did not agree to pay Sprock until later that year, they contend the kickback arrangement was not required to be in the 2001 franchise disclosure documents.

But the judge observed that was not so. “. . . LaGratta’s own testimony . . . states that his agreement with Sprock was formed ‘after the first two Moe’s were opened’ which would have been in 2001—before SOS was formally created.”

In his order, the judge states it is undisputed that SOS was formed in 2002 to house the LaGratta-CRM food supply agreement. But he adds that it is disputed that there was a precursor entity to SOS, and as to when LaGratta agreed to pay Sprock 50% of LaGratta’s profits after expenses.

Sprock testified that he was unaware of any food brokerage company other than SOS Food Service Consultants, which Sprock approved for franchisee purchases. The judge also points out that LaGratta and Sprock testified that CRM was capable of managing all aspects of Moe’s supply chain without SOS. And CRM owner Steven Salzburg gave testimony that “Sprock provided no services to Moe’s supply chain.”

Einhorn said that shows that SOS and Sprock were not even needed. “Everyone testified that Sprock had no role in SOS or the supply chain in negotiating contracts or anything else.” He adds, “From our view, Sprock just inserted himself and the company that he created, SOS, into the supply chain just for the purpose to generate kickbacks.”

Because it wasn’t until 2005 that Moe’s disclosed Sprock’s ownership interest, and that SOS was an affiliate, the judge ruled that certain franchisees could have been harmed by the additional charges on the products they purchased. As a result, the franchisee groups are permitted to stay in the lawsuit and go forwards with certain fraud claims including RICO.

The court ruling also cites misleading statements pertinent to the case from Moe’s franchise disclosure documents as to its requirements of franchisees in purchasing supplies. “. . . suppliers are not affiliated with us [Moe’s]. Neither we nor any of our affiliates will derive any income from these purchases [of supplies].” Disclosure also states that Moe’s “does not negotiate purchase arrangements with suppliers for the benefit of franchisees.”

Litigation shadows Raving Brands

Raving Brands has a long history of litigation under the leadership of Martin Sprock III. In spite of it, the holding company has been able to shed several of its brands through acquisitions that have been taunted by franchisee lawsuits.

With its three remaining concepts, Flying Biscuit, Monkey Joe’s and Doc Green’s Salads, Sprock again is engaged in courtroom battles with franchise owners. Last January two franchisee groups under Doc Green’s Salads filed suit in federal court against Raving Brands and two of its executives. Franchisees allege fraud, breach of contract and misrepresentation.

Martha Logan Decker of Hill, Kertscher & Wharton, representing Raving Brands defendants did not return telephone calls requesting an interview regarding the latest court developments.

Telephone calls and emails to Raving Brands corporate office requesting an interview were not returned.

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