



CFR..

SHARE

USA Baby founder sues CEO for violation of shareholders' agreement

By Janet Sparks
As published in: [Franchise Times - September 2007](#)

USA Baby is facing legal action on several fronts, including investigations from at least three state attorneys general.

USA Baby's Web site tells the story of founder Alan Levine's vision to create a national chain of baby furniture stores, along with his dream of becoming America's leading specialty retailer of children's furniture and accessories. CEO Ron Eriksen is praised for carrying out Levine's original vision, and is credited for developing and implementing both the retail and franchise side of the business to increase the bottom line for franchisees.

But recently the company has been riddled with franchisee lawsuits and three Attorney General investigations. And to make matters worse, on July 11, 2007, Levine and Barry Cohodes, minority shareholders in USA Baby, filed a lawsuit against Eriksen for violating a shareholders' agreement.

According to the lawsuit, USA Baby was founded in 2001 in order to purchase the assets and continue the business of Baby's Room U.S.A., Inc., a similar franchise concept. Prior to the purchase, Levine was CEO of Baby's Room and owner of 86 percent of its outstanding stock, and Cohodes was CFO and owner of 14 percent. But after the purchase, both became minority shareholders with Eriksen as the majority shareholder, owning over 83 percent. Under the provisions of the shareholder agreement, Levine and Cohodes state they have the right to require Eriksen to purchase their shares for an aggregate amount, to be determined, but not less than \$352,300.

One triggering event of the lawsuit is if a lender declares a default under USA Baby's loan agreement with the bank or under any convertible debentures. In November 2006, the franchisor was given a notice of event of default under a \$300,000 Convertible Debenture by franchisees in Arizona, who then filed a lawsuit to pursue their remedies for default.

Levine and Cohodes claim another triggering event over a loss of \$100,000 when Eriksen failed to produce audited financials for 2005 and 2006. He has denied them access to records in order to determine the adjusted net earnings of the USA Baby business. A third event of the suit alleges the loss of more than 10 percent of its franchised stores in 2007.

In addition to the \$352,300 amount for their stock, Levine and Cohodes are asking for costs and legal fees.

More legal woes

Ohio AG names CEO Ron Eriksen in latest suit

USA Baby touts that it is the "No. 1 franchisor in a \$6 billion solid growth market," but in spite of the accolades, the franchise company, along with some of its franchisees, is haunted by legal actions and investigations surrounding consumer complaints.

Through state consumer protection laws, irate customers are demanding USA Baby stores either deliver their merchandise or refund their money. They have managed to get the attention of attorneys general in at least three states.



Janet Sparks is the former publisher of Continental Franchise Review, an industry newsletter that covered the franchise community for more than 30 years before being acquired by Franchise Times Corporation.

Although the stores in question are franchisees of USA Baby, corporate CEO Ronald Eriksen has been at the center when he became a key executive of a new franchisee entity, Midwest Baby Group.

The state action started in October 2005, when Ohio Attorney General Jim Petro filed a lawsuit against franchisee Jim Lankey and his three USA Baby companies, NEO Baby, Baby Bucks and Sunshiny Day. After the AG obtained final judgment against all the defendants, he ordered consumer restitution in the amount of \$13,799. But when a Toledo judge ordered Lankey to stop doing business until customers were paid, Lankey transferred his company ownership to the Midwest Baby Group.

When consumer complaints continued through the year, the Attorney General filed another lawsuit in December 2006, this time not only against Lankey and his companies, but also against Midwest Baby Group and its three principals, Eriksen, Scott Wallis, and James C. Gullett, operations manager for Lankey's operations and then Midwest Baby.

The lawsuit alleged Eriksen, Wallis and Gullett had not lived up to their obligations as principals of Midwest Baby Group, that they have committed unfair, deceptive and unconscionable practices in violation of the Consumer Sales Practices Act.

Aware of their precarious financial situation, the lawsuit states, they continued to take money from customers knowing they would not be able to deliver furniture and accessories. The suit also alleged they stalled and evaded their legal obligations and repeatedly failed to return phone calls to customers and suppliers.

Ohio receives default judgments

In March of this year, a decision was handed down in the Ohio state lawsuit. According to Michelle Gatchell, spokeswoman for Attorney General Marc Dann, the state received default judgments against all defendants with the exception Lankey who is trying to reach a settlement. At press time, Gatchell said the state had not been paid by USA Baby.

Now the franchise is under scrutiny by two other states. Phil Sisneros, director of communications of New Mexico's Attorney General's office, said although no formal action has been taken, they have an ongoing investigation into the business practices of USA Baby regarding undelivered furniture and accessories and failure to refund customers' money. The state has sent a letter to the attorney for USA Baby and Midwest Baby stating that their clients may be in violation of New Mexico's Unfair Practices Act. So far, the company has not responded to its requests.

A spokesperson from the Attorney General's office in Florida said they launched their investigation on August 25, 2006. Currently, 15 complaints have been received by the Attorney General's office, and it is considered an active investigation.

Phone calls to Ronald Eriksen were not returned.

State registrations in question

USA Baby lists approximately 16 states on its Web site under Special Targeted Opportunities Available. According to several states listed, the franchisor is not currently registered. In Rhode Island, the franchisor did a multi-state filing in September of 2005, which was good for one year. It expired April 30, 2006, according to that office. It also did not renew its registration in California. In Maryland, the Securities department said it has never been effectively registered. It started to submit its registration in 2004, but it was abandoned on June 17, 2005, meaning there were some deficiencies which were never cured. Again USA Baby came back to Maryland in September 2006, and was again abandoned on July 16, 2007. The franchisor is headquartered in Illinois and has not been registered since September 2006, according to state records.

[Franchise Times - September 2007](#)

