BAGGER V. DELISHCO
ARBITRATION

Sam (Samuel or Samantha) Kremin
[daughter or son of the founder]
Vice President, Bagger Inc.

Witness Statement/Deposition Summary

You grew up in the Kremin family's business, Bagger, Inc., operated by your father after your grandfather and his brothers. Until about ten years ago, you weren't interested in selling bags. But anyone would agree you were a born salesman: you are a talker who connects easily with customers. You worked for a major wine and spirits manufacturer for ten years, eventually as VP for wholesale sales. Five years ago, that company was purchased by a conglomerate. You had had enough of corporate bureaucracy and decided to go on board at Bagger, Inc. By then, your uncles had died, and your grandfather had retired. Your sibling, Terry Kremin, had been working with your father at Bagger for a while.

Even though your father is technically the owner, the three Kremins at Bagger make decisions by consensus. You tend be more optimistic and gregarious, not surprising given your talent for sales. Terry is responsible for overseeing the books, and what might be called "strategic planning," pushing to insure Kremin Bag's future growth and competitiveness. Your father tends to be very conservative – unwilling to risk large investments for uncertain future gain.

You first heard of an RFP for an exclusive bag supply contract with Delishco when you happened to sit down next to Delishco's VP for Beverage Products at a Chamber of Commerce luncheon, a little more than two years ago. When you mentioned your family business was Bagger, Inc., the Delishco VP, Pat Delahunt, said that his division bought a lot of orange harvesting bags. "In fact," he said, "my purchasing manager just sent out an RPF for an exclusive supply contract to a few multinational bag companies who supplied some of Delishco's other divisions." You asked that he give Bagger, Inc. the opportunity to bid.

Eager for information that would lead to a winning bid, you decided to probe a bit on pricing. You said to Pat: "I bet you're paying $1.15 a bag to your current supplier."

Pat said: "Actually, I'll have to check but I believe we're paying more like $1.20 or $1.30. You chuckled and said:" Well, you are overpaying. I'd say the market price for an order larger than 100,000 bags is about $1.10 - $1.15 per (depending on the size of the order). Frankly, we'd go significantly lower if it were an exclusive supply contract and a guaranteed minimum of much larger annual orders."

Pat responded: "The RFP is for an exclusive supplier. But I imagine Kremin is a relatively small family business. Will you be able to handle our volume?"

You replied: "Yes, we are a proud family business with a long history, but we play in the big leagues. We supply some very large companies who value our service approach. Unequivocally yes, we can handle any volume, whatever it is, as long as we can count on it. But I do have to ask, what would your annual order be – minimum and maximum?"

Pat said, "Well, I can get the exact historical numbers back at the office, but I believe it generally ranges from 10 million to nearly 20 million per year."

You responded: "Well if there were a 50 million bag minimum total guaranteed, on a five-year exclusive supply contract, I bet we'd go down as low as $1.00 per bag."

At that point, the luncheon speaker was about to start, and you and Pat agreed that Bagger would respond to the RFP in writing. And if Bagger's bid were competitive, the VP indicated that more specific terms would be negotiated. He promised to mention to the purchasing manager that he had met you, invited Bagger to bid, and forwarded the RFP to your smartphone.

Back at Bagger that afternoon, you and Terry convinced your father to go "full throttle" after the Delishco contract, at a sharply reduced price per bag. While Bagger's pricing is often somewhat negotiable, the "normal" price for bags of this type in a significant quantity order (say 100,000 or more bags) would be $1.10 – $1.15 dollars per bag (again, depending on the size of the order). For small orders, it would be $1.20 or $1.30 per bag.

Your father agreed to a bid price on the Delishco RFP of $1.00 per bag but if and only if Delishco would agree to purchase a minimum number of 50 million bags. Bagger does realize some efficiencies of scale when sourcing materials and manufacturing these bags, but the actual per unit cost of this type of bag is not lower than 90 cents per bag (a little bit higher on smaller orders).

You, Terry, and your dad recognized that to handle this type of volume, Bagger would have to invest approximately $500,000 in dedicated bag manufacturing and printing equipment. Without it, Bagger would be unable to reliably produce sufficient bags for their other customers. You also agreed that because the 50 million bags would be a minimum, generating $5 million in profits over 5 years, Bagger would also plan on investing about $500,000 to hire a new salesman, expand its web presence, create better marketing materials, and upgrade its building. (You had been pushing to make some of these investments for a while, but your dad had vetoed them as too expensive.)

In short, the Delishco deal offered Bagger the opportunity to join the big leagues because it offered a guaranteed and significant new income source. Historically, Bagger's customers have been smaller – with average orders between 10,000 and 100,000 bags and just a few larger customers ordering as many as 300,000 or 400,000 bags a year. Competition is fierce. You can never bank on the same customers re-ordering, over and over.

You and Terry worked up Bagger's formal proposal to Delishco and sent it right away. A week or so later, you were delighted to receive an email stating Bagger's proposal had been accepted, subject to negotiating contract terms and conditions.

All agreed was that you and Bagger's sales service manager, BJ Borman would represent Bagger in the negotiations. To save time and money, you agreed not to hire a lawyer to negotiate or draft terms. "After all," said your dad, "contracts are about common sense and good faith dealing. If you think you need a lawyer to protect yourself from a customer, then you shouldn't be doing business with that customer. This deal is pretty simple: a guaranteed minimum of 50 million bags, at $1.00 per bag. All you really need to do is work out the length of exclusivity, a reasonable notice time for a large order to allow for production and shipping, and standard payment terms."

The negotiations were actually pretty informal, taking place over a few phone conversations and emails with Delishco's Purchasing Manager, Fran Dalvera. Early on, you requested, and Fran provided the schedule of his orange harvesting bag orders over the past five years. While still quite large, the numbers weren't quite as high as the VP had estimated. According to Fran's records, the bag orders ranged from 7 million to 10 million per year.

You and BJ Borman negotiated once in person with Fran and the VP, Pat, about a week before the contract was written up and signed. The meeting took place when you both visited Delishco's orange harvesting facility. In order to fine tune the bag sealing specifications, you had arranged meet there to see firsthand how the oranges would be loaded and what stresses would be put on the bags.

After touring the harvesting facility, sandwiches were brought into the meeting and a young fellow appeared who was introduced as an inside lawyer for Delishco. Pat Delahunt said it made sense to bring the lawyer in to hear firsthand the business terms of the deal, since he would be writing up the contract. The lawyer was pretty quiet throughout.

Before that, most of the talk has been about a five-year exclusive supply contract, based on Pat's earlier minimum annual number of 10 million. You explained that, given the revised 7 million bag minimum, 5 years wouldn't get you to 50 million bags. You specifically stated: "Without a 50 million bag minimum and exclusivity, Bagger can't stick to the $1.00 per bag price. My dad – Bagger's owner – would never go for that. This discount is only on the table at 50 million bags. After all, even for pretty large customer orders, but without exclusivity or guaranteed minimums, our price is at $1.10."
The Delishco folks heard that and had to understand it. Pat Delahunt replied: "Okay, to be sure the deal will cover 50 million bags, we'll take the contract period out to 8 years." You made handwritten notes of that, and you think Pat did too.

Perhaps because the Delishco lawyer was there, and because you had noticed that the orange harvesting facility was located a few miles from Delishco's main plant, you even asked: "What if Delishco sells off its orange harvesting? Then what happens to the contract? Are there any plans for a sale?" You specifically remember that Delishco's lawyer and Pat both said Delishco was not planning to sell that facility or its orange harvesting operations. They even commented that it might possibly expand to other fruits, which could mean more future business for Bagger.

First thing in the morning about a week later, the Exclusive Supply Contract arrived, attached to an email that stated: "here's the formal contract, incorporating the terms we agreed upon in our meeting. As soon as you've signed it, we'll send you our first order under the contract."

You took a quick look, signed it, and scanned it in, and sent it back immediately.

When Terry and your father arrived in the office a little bit later, you proudly announced that the deal was done, and you showed them the contract. Both of them expressed some concern that the document didn't contain the words "guarantee" or "minimum". You reassured them that this was understood by all, and implicit, and that in the meeting, the VP extended the contract period to 8 years to insure that Delishco would purchase at least 50 million bags. You also showed them your notes from the meeting.

You now know that, over the next week or so, BJ Borman also began to worry about what seemed like a disconnect: why hadn't the contract used the words "minimum" or "guaranteed" when that's what you had talked about? BJ tells you that, just before signing on a purchase order for some new high volume bag manufacturing equipment for Delishco, he called Fran Dalvera and said:

"Hey, I just want to make sure we're on the same page because that young lawyer of yours left it murky in the contract. Before Bagger puts money into equipment, aren't we agreed that Delishco will purchase a guaranteed minimum of 50 million bags at this price, sometime in the next 8 years?

Fran: "This year I think we'll be at the 10 million level. So, no worries."
According to BJ, Fran had said he was on his way out the door at the time, so the conversation ended there.

About six months after the contract was signed, Bagger Inc. hosted a celebration of its 75th year of business and invited many of its customers, along with friend and current and past employees.

You now know from Terry that he ran into Delishco's purchasing manager, Fran Dalvera, at the party and introduced himself. Terry thanked Fran for Delishco's business and commented about being relieved that: "Not only have we made our first 50,000 bags for you by now, but the Bagger team is also delighted to know that our brand-new equipment will be kept humming to for at least the next five years." According to Terry, Fran initially looked startled, and then said, "I very much hope that we'll be harvesting oranges and sending them to you for at least that long, maybe longer. The quality and efficiency of Bagger's performance has been terrific."

Terry responded: "Well, I sure hope this isn't about hope at all. Sam and all of us at Bagger have been relying on at least 50 million bags from the get-go; it's the only reason we got my dad down to $1.00 a bag. "

Fran said: "Yes, I know. Sam told me when we were negotiating that your dad was tough, and we had to get to the magic 50 number, or your dad would nix the deal."

Six months later - just about 18 months into the contract, you received an early morning email from Fran Dalvera, stating that Delishco would no longer require any bags under the contract because they had spun off their orange harvesting operations. The orders stopped almost immediately, and you were only about 15 million bags into the 50 million.

You, Terry, BJ, and your dad all agreed that it was time to hire a lawyer and file an arbitration claim against Delishco for Bagger's lost profits. The lawyer has assured you that you have a great claim, even if the contract itself is less than crystal clear. But, if Delishco knew and lied about the possibility that they would spin off the harvesting operation then the whole thing was trickery and fraud.

Your lawyer has explained that Delishco may try to argue that Bagger could have or should have replaced the Delishco contract with other business. You know that is bunk. No one could possibly work any harder to bring in sales than you and BJ Borman do. In fact, right after the contract was signed, Bagger hired a new salesman with the idea of expanding the business further. The sad truth is that business is not exactly booming for Bagger's customers, mostly in the small to mid-range customers, and competition among bag suppliers keeps profit margins down. You kept the new salesman on for as long as you could – about 6 months after Delishco pulled the plug – but he couldn't pull in enough additional business. It's to Bagger's credit that its other volume has held steady. You are not happy about the $500,000 Bagger invested in the salesman, website, and building upgrades or the additional $500,000 spent on equipment for Delishco bags, now sitting idle most of the time.

