BAGGER V. DELISHCO
ARBITRATION

Terry (Terrence or Teresa) Kremin
CFO and Daughter or Son of the Founder

Witness Statement/Deposition Summary

You grew up in your family business, Bagger, Inc., when it was operated by your father, your grandfather, and his brothers. You worked there in the summers in your late teens and sometimes in college and graduate school, doing a bit of everything, from sales to working with suppliers, to back-office books. After college, you spent two years in hotel management and then got an MBA with a focus in finance and accounting. After a brief stint with the finance department of a publishing house, you decided to make your professional career at Bagger, where you would eventually have an ownership interest. By then, the business was operated and owned solely by your father. That was fifteen years ago. Your elder sibling, Sam, came on board five years ago, after working in sales for a wine and spirits manufacturer.

While you are not an accountant, you are responsible for overseeing Bagger's finances and books, and what might be called "strategic planning." Your role includes pushing your father and Sam to take steps now to ensure that Bagger will grow and be competitive in the future. Your father tends to be very conservative with funds and thus unwilling to risk large investments even if these might grow the business. Sam tends to be more optimistic and has quite a talent for sales. Still, the Kremins at Bagger make decisions by consensus.

Sam first heard of an RFP for an exclusive supply contract with Delishco at Chamber of Commerce lunch, a little more than two years ago. It seemed like a great way for Bagger to get into the big leagues and fund a business expansion, because an exclusive contract with Delishco assured a new and large income source. At that time, Bagger's customers tended to be smaller – with average orders of anywhere 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. So, Bagger has never been able to bank on the same customers re-ordering, over and over.

Sam apparently sat down at a table next to Delishco VP for Beverage Products, Pat Delahunt. When Sam said he was with Bagger, Delahunt mentioned the RFP for orange harvesting bags he had just sent out to a few multinational bag companies who supplied some of Delishco's other divisions. At Sam's request, he emailed the RFP to Sam's smartphone during the luncheon.

Back at Bagger that afternoon, Sam reported that he had engaged Pat Delahunt in an informal conversation about volume and pricing. Delahunt estimated his division's annual order volume at 10 million to 20 million bags and thought his purchasing manager was paying $1.20 or $1.30 a bag. Sam told him he was overpaying, as that would be Bagger's price only for very small orders. Bagger's "normal" price for bags of this type in a significant quantity (say 100,000 or more bags) would be $1.10 - $1.15 per bag ($1.10 on a very large order). That must have gotten Delahunt's attention! Sam said he then told Delahunt that Bagger would go lower for an exclusive supply contract with a guaranteed minimum.

Bagger does realize some efficiencies of scale when sourcing materials and manufacturing these bags, but the actual cost of this type of bag is not lower than 90 cents per bag (a little bit more on smaller orders).

Based on Sam's report, you and your father were in favor of going "full throttle" after the Delishco contract at a sharply reduced price per bag of $1.00 per bag, if and only if Delishco would agree to purchase a minimum of 50 million bags over a 5-year exclusive contract.

According to Sam, the bare minimum of Delishco's order would be 50 million bags. Thus, a minimum of 50 million bags would yield a profit of 10 cents per bag, or a minimum of $5 million. As long as there was a minimum guarantee, it was as good as money in the bank – on top of Bagger's current business.

For that "money in the bank," you all agreed to take $200,000 from current reserves and draw down the Kremins' business equity line by $300,000 to invest a total of $500,000 in some new equipment and upgrades specially to handle Delishco's annual volume of bags. While you had some excess capacity on your current equipment, you didn't have nearly enough to reliably handle the Delishco contract quantities without delaying other jobs and causing dissatisfaction with current customers.

Again, relying on that minimum $5 million in profit, you, Pat, and your father also agreed to invest an additional $500,000 in various business expansion initiatives: new bag manufacturing equipment, website, and electronic upgrades, hiring a new salesman, marketing, and trade show travel, and building improvements.

When Sam and BJ Borman returned from the negotiations at Delishco's facility in Florida, you were pleased to hear they had been successful.

A few days later, after Sam told you he had signed the contract, you looked it over and expressed concern to Sam that the words "guarantee" or "minimum" were not mentioned in the document. Sam forwarded the email from the Delishco purchasing manager stating "we use a minimum of 7 million bags a year, with the average running between 7 million and 10 million. In boom years, we've used as many as 15 million or more."

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.

During the party, you ran into Delishco's purchasing manager, Fran Dalvera, and introduced yourself. You thanked him for Delishco's business and commented about being relieved that "Not only have we made our first 6 million or so 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." 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."

You responded quickly: "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.

"Yes, I know," said Fran, 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.

Less than a year later - just about 18 months into the contract, Sam came in late one morning, clearly upset. He told you and your father that Delishco was not going to buy any more bags, because they had spun off their orange harvesting operations. He was mad! The orders stopped almost immediately, and you were only about 15 million bags into the 50 million. Since then, the equipment purchased and used for the Delishco bags now sits idle for the most part.

You agreed that Bagger should sue Delishco for their lost profits. And if, at the time of the negotiations, Delishco knew about a plan to spin off the harvesting operation, then the whole thing was trickery and fraud.

For heaven's sake, if Delishco's purchasing manager had told you a year earlier that at the anniversary party, you wouldn't have authorized most of the additional $500,000 in expenditures on the website, marketing, the new salesman, and building upgrades. While these initiatives may eventually be worthwhile, they have not paid off yet. Business for your mainly small to mid-range customers is not booming. It's to Bagger's credit that its other business volume has held steady; it has not increased significantly outside of the Delishco order.

