

# **Sourcing Products and Services for the System: Efficiencies and Traps in Supply Chain Management**

**32<sup>nd</sup> Annual Forum on Franchising  
American Bar Association Forum on Franchising**

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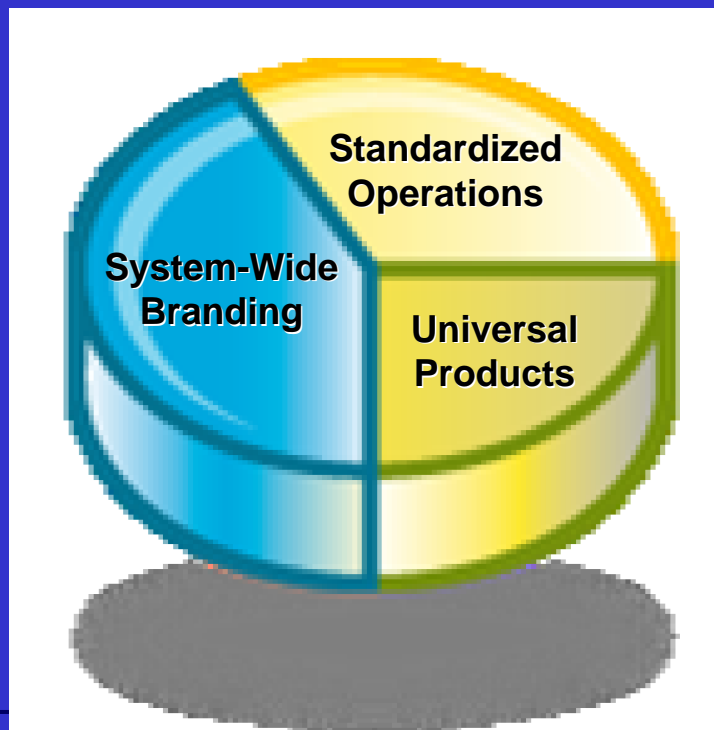
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# Introduction

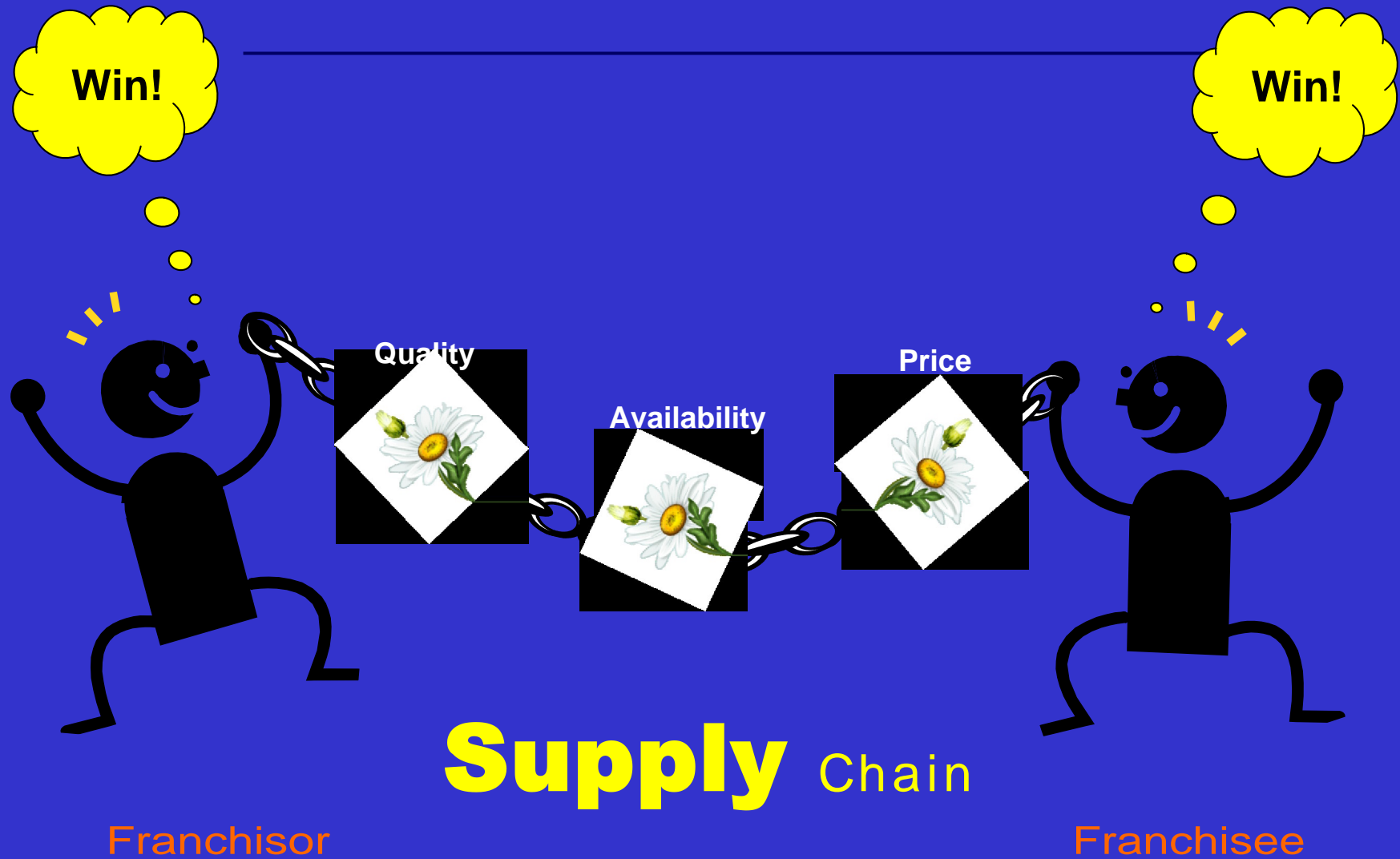
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**“The strength of franchise systems lies in ... the capacity to offer a uniform product”**

- Blair & LaFontaine, *The Economics of Franchising* (2005)



# The Franchisor's Perspective



## The Franchisee's Perspective

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Supply **Chain**

Franchisor

Franchisee

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## Overview

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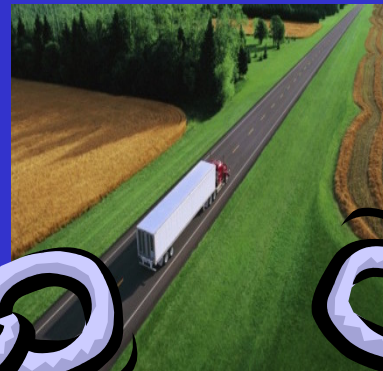
- What is a “Supply Chain”
- What must a franchisor tell prospects about the franchise supply chain?
- Pros vs. Cons of supply chain management
- Best practices



# The Franchise Supply Chain

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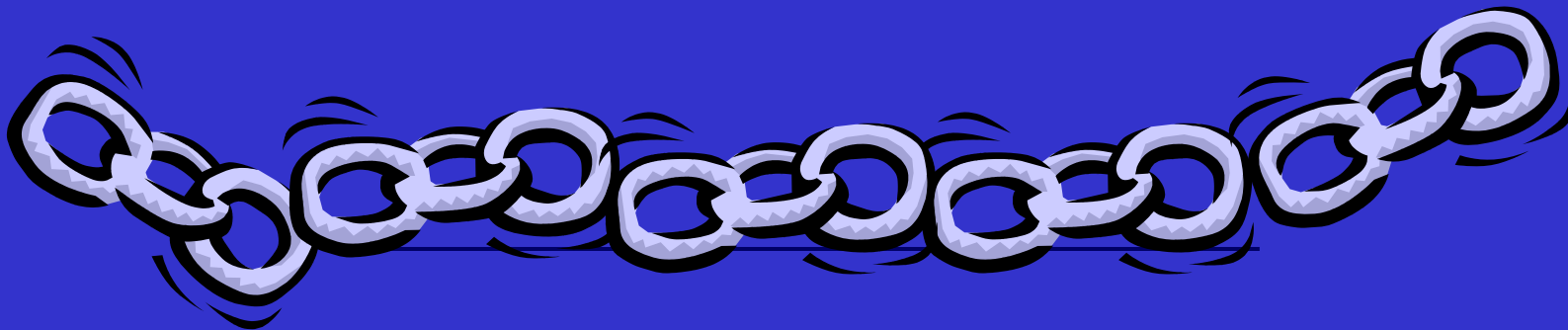
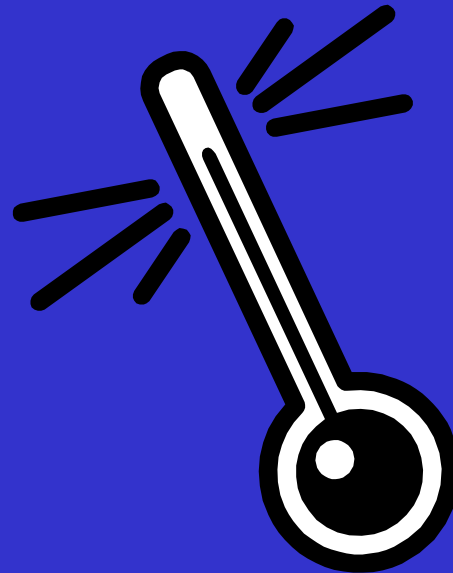
- Producers (manufacturer or vendor)
- Logistics providers (inbound freight)
- Distributors (outbound freight)
- Retailers (franchisee)



## Degrees of Franchisor Involvement

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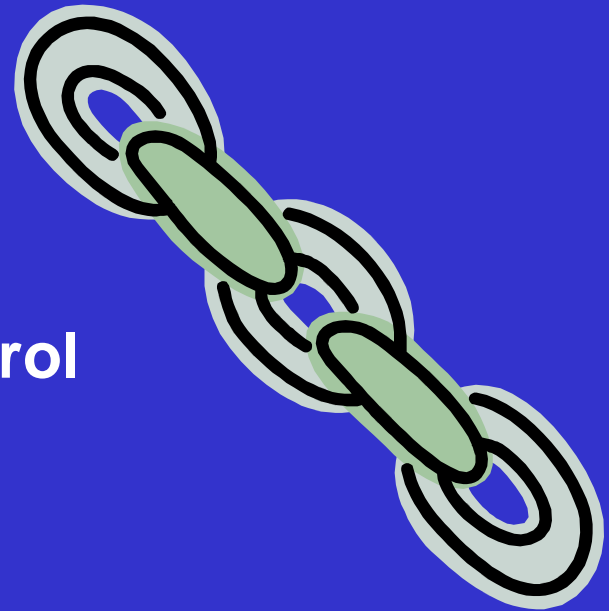
- Minimal (broad line)
- Intermediate (cost plus)
- Full (vertical integration)



## **Why Do Franchisors Create and Manage the Supply Chain?**

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- **Competitive pricing**
  - System-wide purchases
  - Single source distribution
- **Improved safety and quality control**
- **Brand protection**
- **Revenue opportunities**

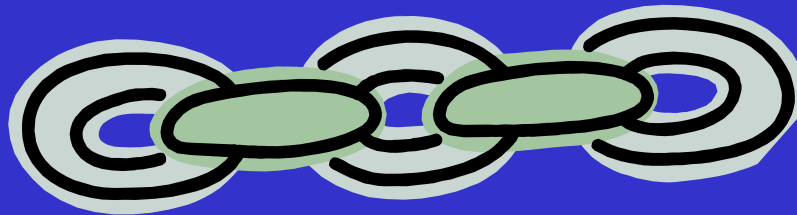




## **Why Do Franchisors Create and Manage the Supply Chain?**

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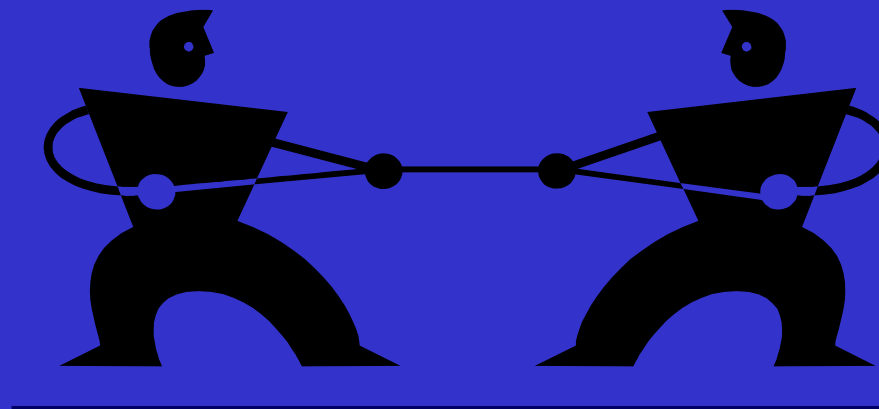
- **Commodity smoothing**
- **On-going product availability: improve franchisee efficiency**
- **Knowledge management**
- **Rapid response to franchisee problems with supply chain participants**



# Relationship Tensions Created By Supply Chain Issues

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- **Economic misalignment of franchise parties**
  - Franchisor profiteering from sourcing controls
  - Franchisee cost-cutting and use of substandard products
- **Lack of competitive pricing: Can everyday prices always be beaten?**



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# The Legal Framework & the Franchise Supply Chain

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- Disclosure duty to new franchisees - Item 8
  - Disclosure of franchisor revenue from franchisee transactions as a percentage of total revenue
    - All suppliers, not just mandatory suppliers
  - Magnitude of sourcing restrictions
  - Conflicts of interest
  - Organized purchasing arrangements



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**Case Study:**  
**Tubby's #14, Ltd. v. Tubby's Sub Shops, Inc. (2006)**

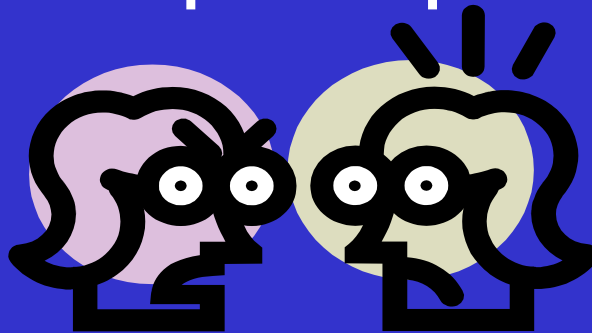
- Failure to disclose profits from mandatory distribution program – “kick backs”
- Violation of Michigan franchise sales law
- Unfair/deceptive practice – statutory fraud
- Potential personal liability



## Best Practices – Disclosure

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- Queen City Pizza v. Domino's Pizza
  - Pre-contract disclosure of sourcing controls
  - Post-contract imposition of sourcing controls
- Future unknown: If there is any possibility of a comprehensive sourcing program, disclose the possible magnitude of sourcing controls as up to 100%
- Real thorn: lack of competitive pricing



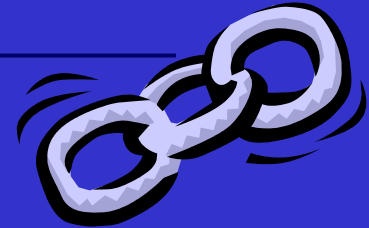


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# The Legal Framework & the Franchise Supply Chain

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- State relationship law issues
    - Indiana: sourcing restrictions for “secondary” goods/services unlawful if comparable quality items are available
    - Indiana: unlawful for franchisor to receive “anything of value” on account of franchisee supplier transactions
    - Iowa: all sourcing restrictions unlawful if items of comparable quality are available
    - Hawaii, Indiana, Iowa & Washington: state relationship laws expressly forbid tying arrangements
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# The Legal Framework & the Franchise Supply Chain

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- Antitrust
  - Exclusive dealing
  - Tying Claims
  - Unfair and deceptive practices



# Best Practices – Vendor Agreements

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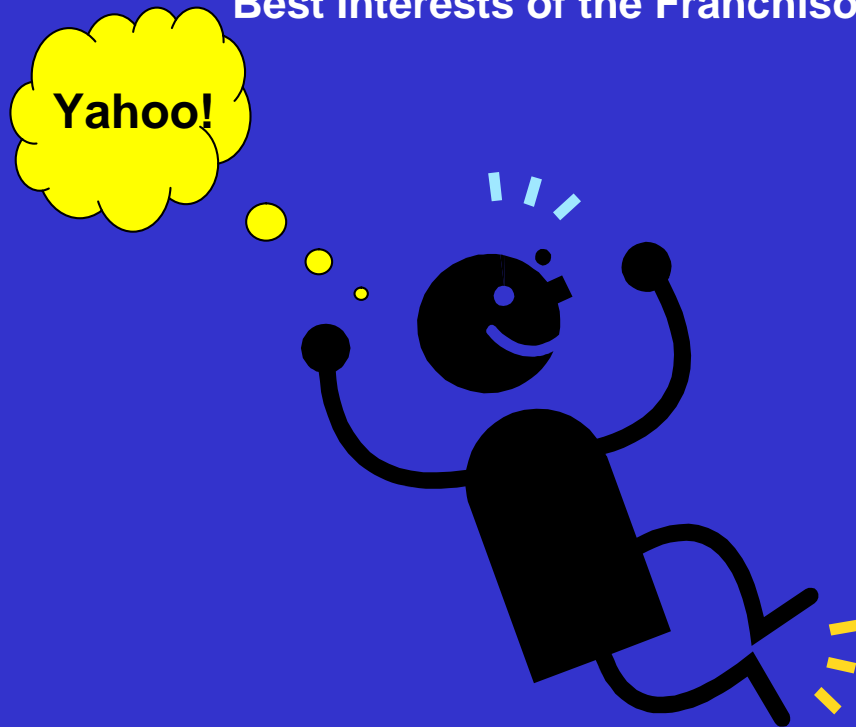
- Vendor agreements
- Purchase orders
- IP protection
- Confidentiality
- Requirement contracts
- Risk of loss, pricing and payment terms
- Warranties, recalls and indemnities



# Finding Common Ground

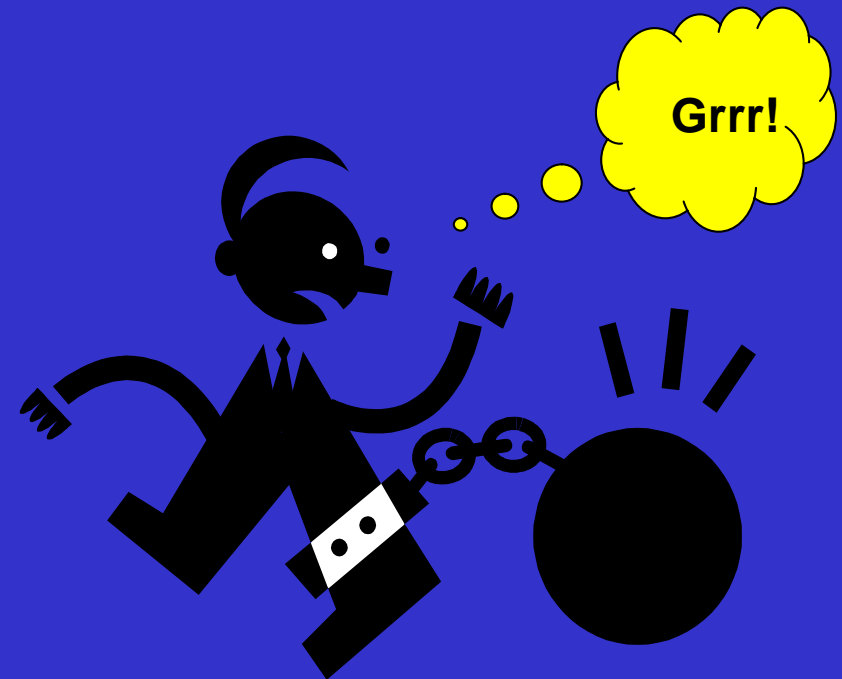
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Best Interests of the Chain  
vs.  
Best Interests of the Franchisor



Franchisor

Best Interests of the Chain  
vs.  
Best Interests of the Franchisee



Franchisee

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# **Thank You!**

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