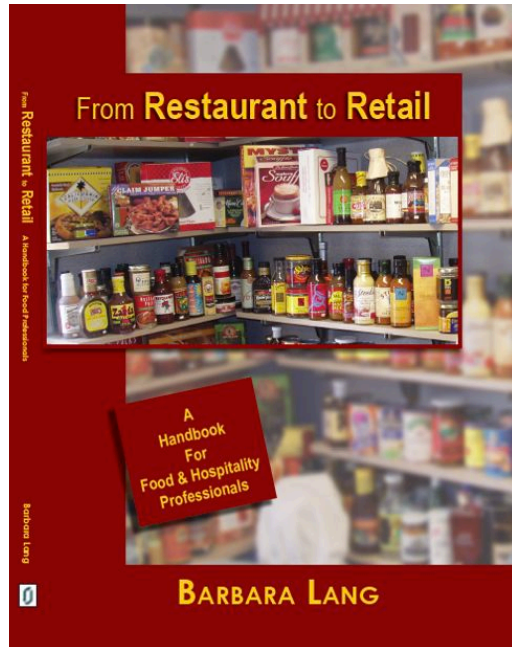
8

CHAPTER EIGHT

Working with a Copacker



Introduction

Once you've selected a copacker, a nondisclosure trade agreement should be signed as a good faith measure, declaring that information discussed between both parties is confidential. The agreements are not necessarily binding legal contracts, so a legal contract soon follows specifying each party's responsibilities. Then real negotiations begin regarding the business contract. Established copackers are veterans in contract negotiations. This is not to imply that copackers are nefarious; a copacker is just more experienced in anticipating controversial predicaments. During times of dispute, wording in the contract can protect the copacker's business. In any contractual agreement, each party strives to create a contract that favors his/her interests. Unless purposeful deception occurs, there is nothing illegal or unethical about this business approach. Recognize that the copacker has negotiated more manufacturing contracts than you.

A nondisclosure trade agreement is viewed as a good faith measure declaring that information discussed between both parties is confidential. The agreements are not necessarily binding legal contracts.

Many restaurateurs, initially ignorant of the manufacturing business, assume their culinary expertise will either override a copacker's traditional process of sourcing ingredients or change the way a product is manufactured even when the contract states no such prerogative. Whether a misconception has to do with formula ownership or ingredient substitutions, you need to walk slowly and methodically through the stages of production and then judge where critical points exist that could result in disadvantageous consequences for you. Lawyers are necessary to confirm language and liability issues; however, if a lawyer is not experienced in the nuances of food processing agreements, then an outside consultant should be hired to review the contract's content.

Owning the Recipe

The contract must outline who owns the final production formula. Wording in the contract may designate you as the owner of the <u>recipe</u>, but unless otherwise specified, the copacker is often the designated owner of the <u>production formula</u>. The production formula, don't forget, lists all your ingredient specifications, and their levels in weight and percentages, along with detailed step-by-step procedures. If you are unfamiliar or unaware of the terminology of ownership, you may not realize this distinction until you request, and are denied, a copy of the production formula.

> **If you are unfamiliar or unaware of the ownership terminology regarding ownership of a production formula, you may not realize until you request, and are denied, a copy of the production formula, that you don't have access to your own formula**.

It is important that you own your production formula – everything can be negotiated in a contract. The importance of your business will often dictate how much the copacker is willing to negotiate. You may not be in a strong bargaining position if you are seeking small production runs and the copacker perceives you as a business with modest growth potential.

> Food Network President, Peter Salmon:
> *"The copacker can make you or break you. Everything needs to be negotiated. I would want my client to own everything. If the copacker does the commercialization of a formula, he is going to consider that to be his formula, and he is also going to use the ingredients that he already has. He may not want to get your ingredients. You need to stand firm on that. They don't want to disclose who their suppliers are. You should own that formula and you should have the raw material specifications for all the ingredients and know who is manufacturing those ingredients and know what the costs are. If the copacker is bearing the cost of developing the product for you, he may feel you are not entitled to that ownership and you have to recognize that. That is the price you pay. But if you believe there is a business here, then it is worth it that you pay for him to do the development work and maintain ownership."*

You should own that formula, and ideally you should have the raw material specifications for all the ingredients, know who is manufacturing those ingredients, and what the costs

are. You may not be in a strong bargaining position if you are seeking small production runs and the copacker perceives you as a business with modest growth potential.

When a copacker offers complimentary product development, this service may initially appear generous, but recognize that this “free” service often entitles the copacker ownership of the final formula. This is not an unreasonable expectation on the part of the copackers since they have dedicated their time and expertise to the formulation. However, be aware of the exchange of ownership from recipe to formula when copackers do extensive product development.

Consultant, Phil Teverow:
“The restaurateur should always strive to be the owner. The problem is if you ask the copacker to do help with production-friendly formulations, then some copackers will say: 'I did this, then I own the recipe. It is a mistake. The brand owner must retain ownership to the formulation -this is minimally prudent."

All products, regardless of whether you or a copacker creates the final production formula, needs to be certified by a recognized Process Authority. This certified process can be put in anyone’s name, and the name on the production formula may imply ownership of the formula.

Cornell’s NECFE marketing specialist Bob Weybright:
“Get the certified process put in your name! It usually goes in the name of the copacker. You have an issue there for attorneys. I know some people who have gotten into a match with copackers in small claims court about a recipe. In the two instances [the] court says: ‘Whose name is certified process under?’ This gives you a different leverage.”

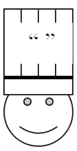
The advantage of a hiring a product development company to produce the formula is that it guarantees you will own the formula; the product development company is hired to develop and deliver that final formula to you and the copacker is responsibility for refining the formula based on test runs.

Frontera Foods, JeanMarie Brownson:
“I have all my formulas. You have to bring that up when you approach the copacker. Even if they scale it up, it is your recipe. A copacker has to sign a nondisclosure and then it is your recipe. You are not at their mercy. They have a factory running at 60 percent; they are looking for work to pay employees and gas and electric.”

Claim Jumper President Craig Nickoloff:
“Whose recipe is it? The copackers should have the recipe scaled up. We have always had ownership of the recipe. Not just the recipe, but the formulation. Copackers like to believe that it is theirs. Maybe it is, but if you can negotiate a way

to own that formulation and you move, you need the formulation. You certainly don't want to go through that learning curve. We didn't know that in the beginning. When we get a new copacker, we tell them the new rules. You need to know those things ahead of time. Like any business, this learning curve was very painful. First year and a half, we lost $2.5 million, while we were doing $10 million in sales."

Often the realization that you don't own a formula occurs if you decide to switch copackers, and you are denied a copy of the production formula.



Curly's Restaurateur and producer of Krista's Jerk Sauce, Krista Van Wagner:
"I never asked for the formula. I wrote the formula that I used to make my certain amount. I didn't ask for theirs or how they were exactly doing it. I am a very trusting person, and I've been burned."

Some copackers are willing to share the exact formulation but will not reveal their procedures or their ingredient vendors. Basically, they share the ingredient levels but not the directions on how the formula is prepared**.** They want to protect what they believe to be proprietary methods, and they don't to divulge their vendors because then their pricing structure becomes more exposed. Again, these are not unwarranted measures of protection; copackers are preserving their position in the industry. However, the importance of your business and the trust that you have with the copacker will dictate how much they are willing to negotiate.

Some copackers are firm in their conviction that because they incur all the product development costs, expertise, and liability, they deserve complete ownership of the final formulas and don't care what someone else comes up with, including formulas from a product development company.

Nondisclosure Trade Agreement

When you begin to sit down and talk about your product profile and ingredient specifications, the copacker will usually initiate the conversation with the nondisclosure trade agreement. If you are not familiar with nondisclosure agreements, request a copy of the agreement prior to the first business meeting, and have your lawyer review the document. The agreement, however, should be signed <u>before</u> a restaurateur's recipe is shared with the copacker.

Both parties need to be open and honest when they first discuss a possible partnership. If you don't let the copacker know what you are thinking about, then you might not be getting the right information from them. Be smart without becoming paranoid. As a food entrepreneur, you may think your product is unique; in all probability, your product is fairly similar to others with some variation that makes it unique to you. (For example, if your product were on the grocery shelf, a good food product developer could do some reverse engineering; just by tasting the product and looking at the ingredient labeling they could come up with a pretty decent facsimile of what you've produced.) But being prudent is smart – before any proprietary information is shared, a confidential or nondisclosure trade agreement should be signed.

Don't be alarmed if some rebel copackers won't agree to the agreement, believing it sends a false sense of honesty and security because, in their opinion, by changing one ingredient by one-tenth and switching the order of a few procedures, they've got a new formula anyway. If you are unsure of the merit of the nondisclosure trade agreement, talk to your lawyer about its significance and legal ramifications.

The Legal Contract

A contract is a guide. When interpretation of the guide is the same for the copacker and the restaurateur, mutual goals can be met and detours, or head-on collisions, avoided. Not understanding the true meaning of certain words or phrases in a contract can have severe consequences; neither naiveté nor ignorance should be a justifiable excuse. Allowing the copacker to direct the content of the contract can prove fatal. Copackers often do not want the client to have too much information about their final product. Maintaining control over the formula and production procedure gives the copacker a considerable advantage, particularly if you want to switch copackers or analyze ingredient costs.

Maintaining control over the formula and production procedure gives the copacker a considerable advantage, particularly if you want to switch copackers or analyze ingredient costs.

Your business may require modest or sporadic productions runs, contributing only a small percentage of profit to the copacker. In these instances, you must realize you will find yourself in the position of needing the copacker more than copacker needs you This imbalance of power plays a big role in contract bargaining and may prevent you from bargaining a contract that best represents your needs. An experienced voice (a consultant and/or lawyer) can help you evaluate your leverage and analyze possible ramifications based on contract wording. Initial contract discussions should not be adversarial; both parties should just be cognizant of their legal position regarding ownership of the formula and products, manufacturing procedures, services rendered, payment, and liability.

Divulging Costs

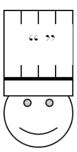
Ideally, you might want to receive a complete disclosure of how the costs of goods were calculated, including the names of the copacker's vendor, costing information for the ingredients, packaging costs, and a breakdown of fixed and variables costs from the copacker, along with their profit margins. But that isn't going to happen because the copackers are then sharing what they believe to be confidential information. In their eyes, this might be similar to you being asked to share your food costs, contribution margin, and labor costs with your customers.

For some restaurateurs, it is not unreasonable for them to see their cost breakdowns, which will enable them to analyze costs and make thoughtful decisions on how to lower costs without sacrificing quality. If you hire an outside consultant to help with quality issues, the consultant will need to know this information. For instance, knowing the type of tomatoes the copacker is using (commodity vs Stanislaus) will impact both quality and price.

Depending upon your proclivity for involvement and the trust you have with the copacker, it may not be important to sweat the details on itemizing costs and profit margins. Demanding this type of auditing may not be necessary or reasonable. You may alienate a dedicated copacker who finds it frustrating and insulting that their decisions and costs are being questioned when they are producing a high-quality product at the agreed-upon price. A lot depends upon your own comfort level with how involved you want to be in the process and how much trust there is in the relationship. It's important to realize that the copacker wants you to succeed – then their production increases and their business improves.

You may alienate a dedicated copacker who finds it frustrating and insulting that their decisions and costs are being questioned when they are producing a high-quality product at the agreed-upon price.

Besides, if you own the production formula (which you should) and it includes detailed ingredient specifications (which it should), you can do the math and estimate costs. Just call a manufacturer to see what they charge for, say, a 50-gallon barrel of vinegar, and figure out the ingredient costs. You'll never know for sure, but you can have an idea.



JeanMarie Brownson, Frontera Foods: *"Restaurants should have some ideas of costs for products that they are getting... and ask for [a] breakdown. If they know how to cost out the sauce in their own place, they can do the same with the copacker."*

EXERCISE # 15 - Specifying Ingredients and Calculating Costs

In order to talk to a copacker intelligently about your product, you will want to convey the rationale for the ingredients you've requested. Refer to the packaging of these ingredients, and write down all information provided about the product. For example, if you are using a red wine vinegar, note the acidity of the product since acidities vary.

Also note the unit size, cost per unit and the cost of the ingredient as used in the formula.

Once you have this information, cost out your product. You will refer back to its cost in later chapters, when packaging is addressed.

Total Yield:		PRODUCT NAME			
Ingredient	Manufacturer	Ingredient Info	Unit	Cost/unit	Cost/qty used
				Total cost	$
Total Cost Per Unit = To get cost/unit, divide the total quanity by the # of units yielded					$

.

First Run

Before commercial production begins, a small benchtop sample is produced. This sampling can be just a half-gallon or a pound of a product. The purpose is to test the product for texture, taste, and color. Texture is the most difficult element to get right in food production. When cooking in a restaurant, your stabilizer for maintaining thickness might be cornstarch or a roux; an egg yolk is used for an emulsifier to avoid water and oil from separating. But on the shelf, stronger stabilizers and emulsifiers are required, impacting both mouth feel and texture.

Once the benchtop sample is approved, a copacker does a limited production run that tests the expanded formula. The end product of that limited run is the property of the restaurateur, not the copacker. The results may not be an exact facsimile of the benchtop product, but unless the contract stipulates otherwise, the product is owned and paid for by the restaurateur, and the run may yield up to 100 cases of product. If the product is not usable, a contract should outline who pays for the wasted run.

To avoid such errors, monitor the production process at each phase. It is in your best interest to be present during this production period. Your copacker should welcome you during this early phase. (The drawback of having a copacker outside of your region is that you need to travel to the copacker's facility, but the time and money spent is worth it if you have found a copacker that fits your needs and values.) Even though copackers say you are welcome, permission to be onsite during production runs and clarification of what "onsite" means should be incorporated into the contract.

It is the copacker's responsibility to produce a product that meets the quality standards set by the production run samples. However, without an agreement, i.e., a contract, responsibility for flawed products can become disputable. To avoid potential disputes, your contract should have outlined clear divisions of cost responsibilities when production runs don't yield an approved product. Having an agreed-upon benchtop sample from which you can compare samples from a large production run is vital; it may be the one proof that illustrates a potential difference between the two products.

Ingredients

Once a benchtop product is produced, the specifications for a formula need to be precise. To make a profit, all parties want to find ingredients at the best possible prices; however, this cannot be done at the expense of a product's quality. What a copacker might find acceptable in taste and flavor may be quite different from what a restaurateur finds acceptable.

Heaven on Seven, Jimmy Bannos:
"You really want to go down and sample their ingredients. What lemon juice do they use? What ketchup base, olive oil do they use? If you are going to manufacturer with what they have in stock, you will save money. But separate ingredients, [that is] very expensive."

Concentrate on what is important for the quality of your product, rather than questioning how the copacker is making their money. Copackers make a profit by purchasing truckloads of a product; the economy of scale plays a big part in their profitability.   If you want a special ingredient, then you are impacting the copacker's bottom line. During early negotiations, spell out the specific ingredients you need, but be open to recommendations from the copacker. Have a range of flexibility so that if the brand of product the copacker recommends doesn't meet your standards, you still have the opportunity to use the original product you requested.

Contracts should carefully outline what ingredients are to be used in a product, with clauses specifying how ingredient substitutions are handled. If a copacker is not forthcoming, potentially inferior products could be used that detrimentally affect the quality of the product and the reputation of the restaurateur.   Substitutions for ingredients should not be permitted without your written consent.

Precise specifications are necessary so products are produced at the quality level set by the restaurateur. To secure the best possible prices, copackers order ingredients in bulk and pay close attention to managing their inventory efficiently. Copackers discourage special order ingredients because they add costs to a product and impact the storage of food supplies. Unfortunately, more often than not, restaurateurs do demand different ingredients from what a copacker may have on hand.

You need to appreciate your copacker's willingness to work with you, accommodating your needs and being flexible. This mutual collaboration makes it unnecessary to quibble or question other, less important aspects of the arrangement.

CP

Mad Will Copacker, Tim Sullivan:

"They [clients] get a copy of their formula….With each ingredient by percentage by weight and the exact specification we are going to use. One of the things, if there is a knock against copacker, [is that] they substitute ingredients. We know that sometimes substituting ingredients will substantially affect flavor profile."

EXERCISE #16 – Sourcing other suppliers

Your copacker may use the same vendor or may use another manufacturer for the same product but just purchase the ingredient in a much larger unit. (For example, one barrel of red wine vinegar is much cheaper than purchasing just one gallon of the same red wine vinegar.) If the copacker doesn't have your ingredient (or a similar ingredient that meets the same specifications) in inventory, you may need to source a supplier. Members of the RCA (Research Chef Association) often post ingredient queries on the organization's list serve and are provided with a several leads from fellow members. You can also use the Thomas Registry, online, to identify suppliers for the products you'll need; however, navigating the Thomas Registry takes patience and you may need assistance (1-800-699-9822). Whenever, possible, note the discounted quantity based on how much you order. Include shipping costs.

Ingredient	Manufacturer	Ingredient Info	Unit	Cost/unit	Shipping	Cost/qty used

Recall

Every restaurateur's nightmare is having a patron become sick from the food served at the restaurant. Usually food poisoning occurs within 48 hours of consumption. If glass, or some other foreign matter, is found in the food, attention and damage control are necessary immediately.

Though the same concerns for food safety exist with packaged products, the time it takes to unveil a problem may be much longer. If a product is recalled, who is held liable – the restaurateur or the copacker? Regardless of who incurs the financial cost (this should be outlined in your contract), it is your name and reputation that can be ruined. The ultimate consequence is suffered by whoever's name is on the package.

The cause of the recall will determine whether the liability will fall on the copacker, the distributor, the retailer, or you. There are two types of recall – "voluntary withdrawal" and "mandatory recall." Voluntary withdrawal is when the company finds out there is problem that won't injure someone but could ruin the reputation of the company – for instance, discoloring or separation of a product. A mandatory recall is determined when there is risk to human health, and you have to get the product off the shelves. Everyone along the line can potentially be held responsible since there are so many points where problems can occur. Your contract should specify all possible circumstances that are common in commercial food production. A lawyer versed in this area of law should be involved. Some copacking companies have recall insurance in addition to liability insurance; you can ask your copacker if they carry the recall insurance and what exactly it entails.

Conclusion

Employing the services of a lawyer is advisable during contract negotiations, but recognize that your lawyer may not be acquainted with industry practices or experienced in identifying the more subtle areas of responsibility, including production errors, substitution of ingredients, ownership of a formula (vs. a recipe), or recall issues.

Restaurateurs unacquainted with what is reasonable to have in a contract may allow themselves to be counseled by the copacker, relinquishing control and potentially sacrificing the health of their business. Copackers need to protect their businesses. Unless they are paid for product development services, copackers will believe the formula work rendered has entitled them to ownership. Copackers have a compelling argument for ownership if they have done product development.

Decide how involved you want to be in the manufacturing of your product. You should make it clear from the beginning how you foresee yourself involved in the production side of the business. Let the copacker know your expectations. The importance of your business will influence how much involvement the copacker feels you should have in their area of expertise.

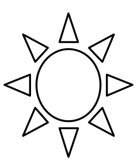
The copacker and the restaurateur need to believe that each party deserves to make a desirable profit. A well-written contract can prevent misperceptions that result in one party feeling betrayed. Going into a relationship with an adversarial persona will not inspire camaraderie and trust. However, ignorance regarding the nuances of the copacking business will not serve you well. It is not up the copacker to educate you in becoming a smart negotiator.

Summary

By the end of this chapter you should have:

- Specified ingredients and calculated costs
- Sourced other suppliers through the Thomas Registry

Key Points



- A nondisclosure trade agreement is viewed as a good faith measure declaring that information discussed between both parties is confidential; the agreements are not necessarily binding legal contracts.
- You should own the formula, and ideally you should have the raw material specifications for all the ingredients, know who is manufacturing those ingredients, and what the costs are. You may not be in a strong bargaining position if you are seeking small production runs, and the copacker perceives you as a business with modest growth potential.
- Maintaining control over the formula and production procedure gives the copacker a considerable advantage, particularly if you want to switch copackers or analyze ingredient costs.
- You may alienate a dedicated copacker who finds it frustrating and insulting that their decisions and costs are being questioned when they are producing a high-quality product at the agreed-upon price**.**