ChemEquip USA Inc.\(^1\) is a small family business established in Pennsylvania in 1984. It has secured exclusive distribution rights from US manufacturers of high-end equipment and parts for the chemical industry, such as gas detectors, safety valves, as well as chemical components. They cover hundreds of different models, for Canada, Mexico, South Africa, Middle-East, Europe and Asia. The consistent characteristic across products is that ChemEquip only distributes the best quality, and charges premium prices. It acts as the export arm for manufacturers who do not feel comfortable and expert enough in pursuing international business on their own.

As ChemEquip’s staff only consists of President and founder John Smith, Mary Smith and their son and VP of Marketing and Sales, Kevin Smith, they cannot be on the ground dealing daily with every single customer in every country they cover. They have therefore operated through a network of local subdistributors, typically focused on one country. ChemEquip provides training and support to each subdistributor, who is the "local face" of the export business, maintaining a minimum level of in-country inventories and close contact with local clients, facilitating customs clearance and local delivery.

On this chilly February 2012 morning, after yet another snow storm, son Kevin hang up the phone and told his father John: "Dad, the manufacturer has confirmed it. It's the Kansas distributor who has been supplying our guy Ex Works." Thinking back about how they ended up in this tough spot, he sighted and added, "It's gonna be tricky…".

**Local Subdistribution 101**

Local subdistributors typically get a distribution contract from ChemEquip. Subdistributors get to buy their products from ChemEquip with a heavy discount based on quantities purchased, and ChemEquip suggests a local retail price to ensure subdistributors maintain a healthy 30-35% profit margin. Some subdistributors do not follow the suggested prices and set higher price points, but they run the risk of pushing customers to the competition.

ChemEquip uses PA law contracts, specifying that any legal conflict will be resolved in a PA court of law. Most often the contract grants non-exclusive distribution rights to the local subdistributor, which means ChemEquip could grant distribution rights for the same territory to another local subdistributor. If a subdistributor wants exclusive rights, ChemEquip would only grant them under the condition that the subdistributor commits to generating a higher minimum volume of annual sales (often around $100,000, as opposed to $30K minimum for a non-exclusive contract). However, even when the contract is legally non-exclusive, ChemEquip used to reward subdistributors with whom they have a good

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\(^1\) The companies and story presented here are real, but all names (companies and individuals) are fictional, due to the legal sensitivity of the matter discussed.
relationship by not seeking out additional subdistributors in the same country. Of course, some countries like India are so large that no single subdistributor can realistically service the whole country. In such cases, multiple subdistributors split the country's territory, without overlap. The non-exclusive distribution rights also allows ChempEquip to maintain direct sales, effectively bypassing a local subdistributor, when a local client reaches out directly to ChempEquip through their website or in the case of long-time local clients who already had a direct relationship with ChempEquip before any subdistributor was selected.

The subdistribution contract requires local subdistributors to maintain a minimum level of inventories at all times. This is to ensure speedy delivery to local clients. The contract also specifies that subdistributors cannot represent and distribute competing products, and that they must buy their products only from ChempEquip: they are not allowed to buy their products from the US manufacturer or a distributor who does not have representation rights for ChempEquip's territory (e.g. an Asian subdistributor cannot buy from a distributor who has distribution rights for a portion of the USA or Europe, while ChempEquip has the exclusive rights to distribute the product in Asia). To make sure that this provision is enforced, ChempEquip gives a list of signed subdistributors to the US manufacturer. If any of them contacts the manufacturer in an attempt to buy direct, the manufacturer has committed to turning the subdistributor down and referring them back to ChempEquip.

The subdistribution contract can be terminated by ChempEquip at any time with a 30-day notice.

The Honeymoon Period

In 1992, ChempEquip President John Smith secured the exclusive rights to distribute a wastewater treatment chemical in Asia from the US manufacturer. He started looking and signing local subdistributors across the region. In 1995, he chose MS Tek, a small industrial equipment retailer as their subdistributor for Singapore and Malaysia. For almost 13 years, the relationship was beneficial for both ChempEquip and MS Tek: sales and profits grew in Singapore and Malaysia.

Betrayals and More Betrayals

Around 2005, sales of the wastewater treatment chemicals generated by MS Tek started to plateau, and gradually eroded over the next two years. In 2009, a VP of the US manufacturer for that product attended a trade show in Singapore, and naturally went to check the sale booth set up by MS Tek to promote the chemical that his employer manufactured and sold to ChempEquip. He was shocked to find that the local subdistributor displayed not only the chemical manufactured by his company, but also equivalent chemicals from the competition. He took pictures of the booth but did not confront the subdistributor about the situation. Instead, he passed the pictures on to ChempEquip.

On his next trip to the region two months later, ChempEquip President John Smith paid a visit to MS Tek in Singapore. He reminded MS Tek owner of his contractual obligations to distribute solely the US manufacturer's products for which he had subdistribution rights, thereby excluding competing products. His reaction was to deny he was distributing competing products. When John Smith pulled out pictures of the Singapore trade show, he reluctantly admitted that he was indeed distributing competing products, and came up with excuses such as the need to answer clients' demands for more choice and lower price points. John Smith firmly reiterated that his company and his network of subdistributors were in the
business of selling US-made quality products that guaranteed peace-of-mind to customers, and a reduced need for after-sales services because of the rare defects and durability of the products. All subdistributors sign a contract that requires sole subdistribution and bans carrying multiple competing brands. John Smith threatened MS Tek with signing on other subdistributors for Singapore and Malaysia. But this did not dissuade MS Tek from continuing their multibrand distribution for another two years.

During these two years, ChemEquip staff, either President John Smith or VP of Sales and Marketing Kevin Smith, continued to visit the region and meet with local clients. Several clients confirmed that MS Tek was providing consistently poor service, and often tried to convince them to switch to a competing brand, luring them with lower prices.

**Termination That Never Ends**

In 2011, John Smith sent a termination letter to MS Tek: they were no longer an authorized subdistributor of the wastewater treatment chemical for Singapore and Malaysia. The US manufacturer also sent its own letter to MS Tek to articulate that MS Tek was no longer allowed to use their intellectual property (brand, logo, etc), products and promotional material.

This should have been the end of the story, but it wasn't. For the next two years MS Tek continued to distribute the wastewater treatment chemical made by the same US manufacturer. As he could no longer get them from ChemEquip, MS Tek's owner managed to find parallel channels to purchase inventories: he bought online under three different company names from distributors in Europe and the USA, requesting Ex Works terms, which allowed him to buy locally and arrange shipping to Asia without the distributors knowing the final destination. Of course, the distributors had no incentive to investigate: it was a 'don't ask, don't tell' situation. If they had known that MS Tek was their customer, they would have been legally obligated to turn them down. MS Tek often bought chemicals that were at the end of their shelve lives (usable for 3 or 4 weeks when sold to their local clients), so the distributors were eager to close the sale before the products were no longer sellable. MS Tek thereby continued to distribute the chemicals in Singapore and Malaysia, often at a discount because of the low shelf life, pretending to be an official subdistributor to its clients, and using the US manufacturer's intellectual property. Meanwhile, ChemEquip kept sending letters to MS Tek ordering them to cease their illegal retail activity.

**It's Not Over Until it's Over**

In February 2012, the US manufacturer had finally managed to track down who MS Tek's behind-the-scenes distributor was: a Kansas company who had domestic distribution rights. They had been selling Ex Works to a company under a different name than MS Tek. They did not know it was a front company set up by the wife of MS Tek's founder.

Kevin Smith wondered what their strategy should be to effectively bring this messy situation to closure. *Should ChemEquip sue MS Tek? What other actions might work?*