

# In Focus: Business Insights

## Think Tank

# Protecting Your Brand, Minimizing Your Risk

Michael Goldberg shares a legal perspective on how brands can protect themselves amid industry-wide retail bankruptcies.

**The pressures on brands** – luxury or otherwise – seem to increase with each passing day. The question of how to best drive sales and profits confounds executives. Online sales proliferate, but brick-and-mortar retail remains critical to both a brand's market perception and its success. Meanwhile, the struggle of retailers is another well-reported story over the past several years. A string of retail bankruptcies – from Sears/Kmart to Forever 21 to Barneys, coupled with the demise of the American mall and other factors – all compound the problem.

One obvious solution is company-owned stores. Vertical integration drives profit, and the brand (along with its “story”) are presented in a controlled environment. But that solution isn't practical for most. This article will focus on how brands are trying to renegotiate their relationships with retailers in ways that offer the most protection possible.

### BRAND PROTECTION: AN OVERVIEW

In analyzing the various solutions, it is critical to first understand what is often the root of the problem. The traditional retail approach involves first showing a line to a retailer; the goods are then typically ordered by the retailers' merchandise managers and staff, and then sold and delivered “on terms.” Those orders are subsequently filled by the brands, with payment typically made 30 to 60 days later.

To avoid the risk of nonpayment, credit insurance is a must for the majority of brands, but, it has gotten increasingly expensive. Additionally, for brands that factor their merchandise (factors and other lenders often offer credit insurance as part of their services), credit approval is not always available, as lenders are constantly assessing (often downward) each retailer's financial wherewithal. But the problems exist beyond mere



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nonpayment. Specifically, since the title to the goods typically passes upon delivery, the brand also loses control over the merchandise as soon as the delivery is made. When a retailer fails, that merchandise often finds its way to off-price channels and the gray market.

It is difficult to understate the risks borne by brands in these instances. Specifically, the brand has incurred a significant expense in manufacturing the delivered goods, which may not have been paid for. Thereafter, those same goods are offered for sale and sold at substantial discounts through unauthorized retail channels, which can hurt brand equity for seasons or years to come. Further still, customers purchase those same goods at the lowest price, and thus do not purchase the brand's full-price goods, including at the brand's own boutiques. The resulting lost sales compound the damage even further. While this risk is particularly acute for luxury goods, no brand can tolerate this outcome.

Furthermore, these risks have only increased as of late, given the mounting challenges faced by brick-and-mortar retailers. What can be done, and are there alternatives acceptable to both retailers and brands? Two options stand out.

### ALTERNATIVE OPTIONS: CONCESSION AGREEMENTS AND CONSIGNMENT RELATIONSHIPS

The first option often is a concession agreement, also referred to as a “store-within-a-store” relationship. This relationship is typically characterized by a “lease/license,” which gives the brand a defined section of a store where it can sell its product. The goods are received and stored by the brands in a segregated area that is staffed by the brand, which enables the brand to maintain control over its inventory. The benefits to the brand are manifest. Since the goods are received and stored by the brand, the title never passes to the retailer, and the risk of nonpayment is mitigated. In addition, since the space is controlled by the brand and managed by the brand's own sales staff, the sales and service environment is controlled almost exclusively by the brand. In the event of the store's bankruptcy, the brand can protect its goods, which it continues to own and control. In exchange, the brand pays the equivalent of rent, which can be – and often is – calculated in part or in whole as a factor of sales.

For retailers, this approach eliminates the need to carry inventory and the risks associated with excessive or incorrect inventory acquisition. In addition, payment for the space (often via monthly license payments) ensures regular income and overhead is reduced, particularly given that the brand supplies the sales staff. While this alternative provides benefits to the retailer, most retailers see themselves as more than just landlords who rent out space, and may be reluctant to proceed on this basis. One recent exception is the Barneys' flagship store, which, it is believed in the market, will be proceeding on this basis. Other retailers are increasingly willing to consider these types of relationships only for

the most important brands (typically those that drive foot traffic), under the presumption that it is better to make an accommodation rather than lose the brand presence and resulting traffic altogether.

A second option that is considered more frequently is a consignment relationship. Typically under a consignment arrangement, goods are delivered according to a detailed written agreement under which the title remains in the brand. The title does not shift to the retailer on delivery, and the retailer does not have to pay until the item is sold. One obvious benefit to a brand is that in the event of a bankruptcy, the goods can be recovered since the title never transfers (presuming all of the requirements have been followed, including the timely filing of UCC financing statements). Brands have to wait for payment until the sales are made, and this risk and delay in the receipt of income can be challenging.

Brands may also be reluctant to proceed with a consignment relationship in cases where there are many stockkeeping units, since there can be a significant administrative expense in monitoring sales and ensuring timely payment. Although technology has made this process more reliable, this alternative often involves delays in payment and product “loss.” In addition, this option is frequently precluded by the retailer's lenders, whose consent is often required under a pre-existing, senior security interest in all goods delivered to a store. These lenders rely upon the retailer's inventory as security for the indebtedness, and are unwilling to forfeit that protection even when a specific brand's goods are imperative to a store's success.

### ADDITIONAL CONSIDERATIONS

If neither alternative works, brands have been seeking other protections, including pre-payment for merchandise. Brands have also been requesting that retailers contractually acknowledge limitations on their rights with respect to the delivered goods, including limitations on the store's ability to discount (often through uniform pricing policies) or sell to the gray market or outside of a single, approved channel. If written properly, these contractual provisions, found in stand-alone authorized dealer agreements or incorporated into the relationship terms and conditions, may be enforceable and offer significant protection. Although far from certain, it is possible that bankruptcy courts may also enforce these types of provisions.

As this article suggests, there are no easy fixes. As retailers continue to struggle and retail bankruptcies proliferate at an alarming rate, brands continue to attempt to negotiate protections to mitigate the significant risks they face. It is incumbent on all parties to creatively negotiate mechanisms that accommodate retailers' mandates, but also offer sufficient protection for brands that face significant challenges of their own, and whose finances and brand equity continue to be diminished by the current retail landscape.

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Barneys' liquidation sales.



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