

SUPPLIER AGREEMENTS

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1. Nature of Supplier Agreements

Manufacturers make the goods which are sold. These goods are sold to consumers by distributors of the goods. This paper will consider the contract between the distributor (the middle man) and the manufacturer – the Distribution or Supply Agreement.

Often the first issue to consider will be whether the distributor is a true middle man or whether he/she is simply an agent for the manufacturer. In most commercial arrangements, the middle man is a distributor, that is it has a contractual relationship with the manufacturer and with the consumer and, in effect, forms a buffer between the manufacturer and the consumer. The distributor is involved in marketing the product, often in servicing the product and certainly in obtaining a profit from the sale of the product.

Where the middle man is an agent, the contract is between the manufacturer and the consumer. This relationship is more common where the goods being sold are highly technical, such as scientific equipment or where it is of a high cost such as mining equipment and therefore there is a low turnover. In those circumstances, because of the low turnover it is more difficult for a middle man to be able to purchase the equipment and on-sell it for a profit and also in those circumstances, the ongoing service needs to be undertaken by the manufacturer. The type of supply or distribution agreements which I will consider is the traditional situation where the middle man is not an agent and enters into a contractual relationship between the manufacturer and the consumer.

I am looking at four specific elements of the Distribution or Supply Agreement:-

1. Quality Issues
2. Retention of Title
3. Risk
4. Termination without breach.

There are many other issues which would be raised in such a contract between the manufacturer and the distributor including:-

- Whether the relationship is exclusive for a particular area in which case it would be important for the Agreement to specify the area.
- How payment is to be made. In the simplest arrangement, the distributor takes the risk of the on-sale so that payment will be on terms with the seller/manufacturer. There are any number of alternatives to allow for payment within a specified time, upon receipt of payment for the goods from the consumer or for payment to be based on a percentage of the on-sale price. Where payment is dependent upon receipt of payment from the consumer or is based on the percentage of the price paid by the consumer, the manufacturer will require a right to inspect the books of the distributor or to be provided with audited accounts from the distributor.
- The Distribution Agreement would include provisions for termination on default including the grounds of default such as liquidation of the distributor, breach of the term of the contract particularly the requirement to pay for the goods, breach of an obligation to notify of any change in control of the distributor company or failing to meet key performance indicators.
- Often Distribution Agreements will contain KPI's such as the sale of a particular number of the items, pre-agreed increase in sales on a year on year basis etc. KPI's are more likely to be found in an exclusive arrangement because under a non-exclusive arrangement, the manufacturer can always appoint another distributor within the area to sell more aggressively.

2. Protection of Quality and Supply

In the past, a distributor or seller of goods could visit a factory to inspect the way the goods are made, it could send someone to test the goods before they were shipped and they could have a belief in the "quality" of the goods supplied based on the "good name" of the manufacturer.

Today goods are unlikely to be manufactured in Australia or they will be assembled in Australia using imported components. The internationalisation of the manufacturing process means that it is more difficult for the retailer of goods to have an adequate knowledge about the manufacturing process of the goods being sold or of the component parts of the goods being sold.

2.1 ACCC

The Australian Competition and Consumer Commission protects the public from unsafe goods or practices. For example, on 1 January 2007, ACCC published a guide to buying safe toys, a guide to bunk bed safety, a guide to baby walker safety. The ACCC has the ability to order a recall of products and its website has a list of the recalls. Over the past month these have included Mattel Barbie branded toys and Fisher Price toys, Petzel Sarken Crampons, Orford Refrigeration cabinets and refrigeration hot box ovens, Kidz bunk beds, Ezzy Peezy slide, Mothers Choice Innerspring Cot Mattress etc.

The Parliamentary Secretary to the Treasurer, Chris Pearce, in a statement in late September indicated the government would propose a national ban on some toys due to concerns about Chinese imports and health of children. Retailers could face fines of up to \$1.1M as part of the crack down. The ACCC surveillance officers are able to buy suspicious toys and have them tested by government laboratories. The problems arose because some toys manufactured in China had increased levels of lead in the surface paint. The department secretary indicated that it was not a product recall but a national ban.

You will recall that there was similar action taken during the Brisbane exhibition because of high levels of lead in some of the painted novelties in show bags.

The Trade Practices Act section 65C contains the power to restrict supply of goods:-

- Where there is a prescribed consumer product safety standard and the product does not comply;
- Where notices issued to declaring the goods to be unsafe; or
- Where a notice imposing a permanent ban has issued.

Under these provisions, the importer/seller will have the responsibility to satisfy itself that the goods comply with the Australian standards.

For example in the Happy Hippo case [McInnis v The Global Imports Pty Ltd (1993) ATPR 41-206] the importer brought into Australia a toy, the Happy Hippo, from Korea. The Korean manufacturer had indicated that the toy had complied with Korean safety

standards and the importer believed that the Australian standards were similar and that therefore the toy would satisfy the Australian standards. After orders had been delivered to Australia, the Happy Hippo was found to contravene the consumer policy dealing with the "drop test". The importer was liable to penalties of up to \$200,000.00 but was only fined \$1,000.00 for the first offence and \$4,000.00 for the second offence because he had taken some steps to satisfy himself that the toy had at least past the Korean standards.

There are numerous examples of cases where the ACCC has taken an importer or seller to court and imposed penalties for failing to comply with Australian standards.

The issue for a distributor is therefore complex. The distributor will be liable in Australia for any breach of Australian law. While there maybe some reduction in penalties (as in the Happy Hippo case) where the distributor has undertaken some preliminary investigation about safety standards in the manufacturing country, this is not a answer to a breach of an Australian standard.

Even where a sample of the goods has passed the Australian standard, the distributor can be liable if subsequent imports are of a lesser standard and fail to meet the Australian requirements. The distributor can also suffer loss because of a ban on selling goods such as goods which has unacceptable chemicals (such as balloon blowing kits which contain Benzene) or because of a blanket ban of imports such as some fire crackers.

2.2 Drafting Issue

In the supplier/distribution contract, the distributor should make sure that there is a clear description of the goods being bought. Often contracts will use short hand such as just stating the name of the product such as the Happy Hippo. It is better for the contract to include a full specification setting out the nature of the material with which the Happy Hippo is made, a photograph of the completed product and details of any paint etc. The contract should also state that the goods comply with the Australian standard for that product (if applicable).

The contract can provide that the manufacturer must comply with a international quality standard such as ISO9000 and also require that the manufacturer has regular audit of its quality program. This may provide some comfort that the goods is specified will in fact be manufactured and that the manufacturer has processes in place to ensure that each of the components conform still specification. This will be particularly important where the goods are toys, foods stuff or pharmaceuticals.

2.3 Action By Distributor

Where goods have recalled, under sections 65F of the Trade Practices Act the order may be on the basis of the supplier having to contact all customers and inviting them to return goods for repair or replacement or simply advertising and allowing the consumers to have an opportunity to have the goods repaired or replaced. In the case of a recall, the distributor is required to undertake the work without costs to the consumer.

The distributor should have an insurance policy for product liability and product recall to protect against costs of the recall. The distributor may have rights against the manufacturer but when that manufacturer is offshore, the rights of bringing in action for damages can be illusory.

Where the supply is between two Australian companies, the purchaser of the goods will have a valid action for the costs incurred provided that the contract adequately identifies the goods to be supplied and the buyer can establish that the goods which have been supplied (and paid for) do not comply with contractual specification.

3. Retention of Title

You are all, I am sure, familiar with the basic concept of a retention of title clause or as most lawyers tend to refer to it – a "Romalpa Clause". At its simplest, a retention of title clause does just that – retains title or property in the goods until the buyer has paid the purchase price of the goods in full, even though the physical possession of the goods is given to the buyer.

3.1 Romalpa

The retention of title clause or Romalpa Clause owes its origin to the celebrated English case of *Aluminium Industrie Vassen B.V. –v- Romalpa Aluminium Limited* [1976] 1 WLR 676. In this case, the retention of title clause contained in the seller's conditions of sale stipulated that the property in aluminium foil supplied was not passed to the buyer until all monies owing was paid. The clause was an elaborate one requiring:

- the buyer to store the goods in such a way that they were clearly the property of the seller;
- where the goods were used in the manufacture of other articles or mixed or added to another object, the new object was to be owned by the seller as security for payment of all debts owed to the seller;

- until full payment, the new objects were to be kept by the buyer as "fiduciary owner" but the buyer was entitled to sell them to a third party within the ordinary course of business.

When the buyer went into receivership, a large part of the purchase price remained unpaid to the seller. The buyer had in its possession unused aluminium foil and also proceeds of sub-sales of the aluminium foil. The court in this case found for the seller allowing the seller not only to retake possession of the unsold foil but also allowing the seller to trace the proceeds of the sub-sales.

The tracing aspect of this case is interesting and the court in the Romalpa case took a liberal view of the concept of a "fiduciary relationship" between the parties.

The essential purpose of a retention of title clause is to protect the seller from the insolvency of the buyer in circumstances where the price of the goods remain unpaid and to "beat the bank" and other creditors with registered security interest and for would otherwise have priority over the interests of the seller.

3.2 Basis of Retention of Title Clauses

The basis of the retention of clause is that title or property in the goods does not pass from the seller to the buyer until the buyer has paid the purchase price in full. The right to determine when title passes is legitimised by sections 20 and 22 of the *Sale of Goods Act 1896*.

Over time, the retention of title clause has been extended to allow the seller to:

- trace the proceeds of any sub-sales by the buyer;
- assert title over new products in which the supplied goods have become incorporated or "co-mingled" in the course of some manufacturing process;
- trace the proceeds of any sub-sales of such "co-mingled" goods;
- retain title in goods pending satisfaction of all or any indebtedness of the buyer to the seller referred to as "current account" or "all monies" retention of title clauses.

The risk of loss however is almost always stated to pass to the buyer on delivery.

The basis stipulation of retention of title clauses have also been further supplemented by provision such as:

- the goods being required to be kept separate and apart from the buyer's other stock so as to be readily identifiable;
- the buyer being required to deposit the proceeds of any sub-sale in a separate bank account, once again for the purpose of identification and to allow the seller to trace the ownership of the goods into such proceeds;
- the stipulation that the buyer holds the goods or the proceeds of any sub-sale in a fiduciary capacity or as bailee or the agent of the seller.

3.3 Attitude of the Courts

The courts recognise and have no difficulty in upholding a straightforward retention of title clause where the goods remain identifiable as those comprised in the contract between seller and buyer. Difficulties however arise where the goods are co-mingled with other goods so that they lose their identity or where goods are irretrievably affixed to other goods or become fixtures to land. Retention of title clauses which attempt to assert title over new products or end products have been found by the courts to constitute a charge over the new products or end products and accordingly being a charge, lose their effect for want to registration.

The courts have recognised that each case must turn on:

- the particular wording of the clause involved;
- the precise questions raised for decision;
- the conduct of the matter in the court; and
- all the circumstances of the case.

3.4 Tracing the Proceeds of Sub-Sales

A retention of title clause would cease to be effective so far as repossession is concerned where the goods have been on-sold and the subsequent buyer had no notice of the original seller's interest. In such a case, the question which may have to be determined is whether the seller would be entitled to trace the proceeds of such on-sale.

Tracing is a legal remedy which itself is fraught with difficulties. The equitable doctrine of tracing relies essentially on the existence of a fiduciary relationship between the parties. Reference in clauses to the buyer being a fiduciary or a bailee or agent of the seller is aimed at enabling the seller to rely on the equitable doctrine of tracing in the event of the buyer's insolvency. Under this doctrine, an owner can "follow" property held by the fiduciary, even where the property has been transformed into cash or other property.

Whilst the courts (in particular the English courts) have recognised the right of a seller to trace the proceeds of on-sold goods where an intention to create a fiduciary relationship between the seller and the buyer is expressed in the retention of title clause, the courts have been generally reluctant to allow the right to trace to be enforced, preferring instead to characterise the tracing interest as constituting a charge.

Where the goods have been on-sold but the proceeds kept in a separate and identifiable account, tracing does not pose any difficulty. Where however the buyer has not kept the proceeds of an on-sale in a separate account and they are not identifiable the seller has to rely on the equitable doctrine which require proof of the existence of fiduciary relationship before tracing as a remedy is available.

There is a whole body of law dealing with the concept of fiduciary or "trust" relationship. Merely stating in a retention of title clause that a buyer is in a fiduciary relationship with the seller does not automatically create such a relationship, particularly where the circumstances of the relationship actually point to one of creditor and debtor only.

3.5 Provision of Credit

The question of tracing and the notion of fiduciary relationship between seller and buyer is often complicated by the provision of credit which is generally allowed to supply arrangements. It has often been argued that the provision of credit is incompatible with the requirement that the buyer is to account to the seller for proceeds of sub-sales. Provision of credit is also not consistent with the agency principles. Agency principles (where one may be arguing that the buyer has on-sold goods as agent for the seller) also neutralises the possibility of a fiduciary relationship and hence, the obligation to keep the proceeds of on-sales separately.

One suggestion to overcome legal difficulties is to couch the credit provisions as an allowance subject to the duty to account for the proceeds of sub-sales on receipt.

3.6 Co-Mingled Goods

Where goods are co-mingled so as to lose their identity, for example:

- the fibre used in carpets (re *Bond Worth* [1980] 1 Ch. 228);
- resin used in the making of chip board (*Borden UK Ltd –v- Scottish Timber Products Ltd* [198] 1 Ch. 25);
- leather used in making handbags (re *Peachdart Ltd* [1984] 1 Ch. 131).

The weight of authority is against being able to trace ownership into the new product. A clause which attempts to assert title over the new product would be constituted as a charge, which not being registered, would (in Australia) be void against a liquidator. It would not be void against a Receiver or Receiver and Manager but loses out in the priority stakes.

A New South Wales case held that the retention of title clause created a registrable charge that was void against an administrator. The case, *Associated Alloys Pty Ltd –v- Metropolitan Engineering & Fabrications Pty Ltd* (1996) 14 ACLC 952 held that because the steel supplied by Associated Alloys had been incorporated into totally new products, the provisions of the retention of title clause was unenforceable, although its requirement that if *Metropolitan* used the steel in manufacturing process, it was to hold a portion of the proceeds of sales in trust or was held to have created a charge. The charge being unregistered was accordingly void against the administrator.

A majority of the High Court found on appeal [(2000) 74 ALJR 862] that an appropriately drafted clause can create a trust and not merely an equitable charge so that a trade creditor can assert a property interest against a liquidator as the trust does not have to be registered.

In *Associated Alloys*, the supplier had included a typical "Romalpa" clause in the Supply Agreement purporting to assert that the supplier's ownership of not only the raw materials supplied but of the proceeds from the sale of any products manufactured from the steel. The liquidator claimed that even that if the clause was effective in granting a proprietary right over the proceeds paid to the seller, that right was created by way of a charge and was therefore void against a liquidator.

The High Court dismissed the supplier's appeal from the New South Wales Supreme Court but only on the grounds that the supplier had not produced sufficient evidence to establish that any of the assets presently held by the insolvent company

were in fact the proceeds described in the clause. The majority found that a reservation of title clause creates the trust and not a charge and therefore did not require registration to be effective.

If the supplier had been able to prove the receipt of proceeds from the sale of goods using its steel, a trust would have been created and the supplier would have been able to trace the beneficial interest in those proceeds.

Kirby J defended on the basis that public policy requires that creditors of a company should be able to identify claims which have priority to their interest, that is by way of register of charges.

In practice, the supplier should have been able to bring evidence connecting receipts from customers with its supplied steel and to trace the proceeds into other assets held by the company. The manufacturer would normally keep a record of inventory and receipts that would be able to identify the proportion of any paid invoice attributable to the supplier's components.

3.7 Affixed Goods

Where goods are affixed to other goods, for example accessories attached to a motor vehicle or parts in an engine, the generally accepted test is whether there can be separation of the original goods without destroying or seriously injuring the end product. The easier it is to detach the original goods from the end product, the less likely it is to be construed as an inextricable part of the end product and the retention of title clause would continue to be effective.

If the goods have been incorporated in the new product so as to form an integral part even though still identifiable, the retention of title clause could not be invoked on the seller's behalf. The goods cease to be the exclusive property of the seller and thereafter only acts as a charge on the new product and any provision in the retention of title clause purporting to convert ownership of the new goods on the seller would be ineffective.

3.8 Fixtures

Goods can become fixtures, that is, become so attached to land so as to form (in law) part of the land. The applicable tests are:

- the degree of annexation; and
- the purpose of annexation.

In the case of the degree of annexation, an article is prima facie a fixture if it has some substantial connection with the land or building on it. For example, timber used in the construction of a building or bricks used in a wall. Something which rests on the ground on its own weight is not generally a fixture.

The test of the purpose of annexation is used to distinguish convenient use as a chattel. For example, valuable tapestries nailed to walls of a room for display purposes were held not to be fixtures, whereas, seats secured to the floor of the cinema were held to be fixtures. The question of whether an article the subject of a retention of title clause had become a fixture was dealt with by the Supreme Court of Queensland in the case of Southbank Corporation & Anor –v- Steelfine Fabrications Pty Ltd (the Gondwana land case). Steelfine Fabrications had supplied the steel cable mesh and membrane for the Gondwana Land site at Southbank. Steelfine were owed approximately \$73,500.00 under its contract with Gondwana Rainforest Sanctuary Pty Ltd (Gondwana). When Gondwana went into receivership Steelfine sought to remove the steel cable mesh and membrane pursuant to retention of title clause. The application to the court was Southbank Corporation and the Receiver for Gondwana seeking an injunction to stop Steelfine from removing the steel cable mesh and membrane.

The receivers for Gondwana argued that Steelfine's right to remove the material was lost because of the affixation of the steel to the site. The court however found that the material was totally demountable and easily removed. In the court's view "one vital factor in the analysis of the right of the parties concerns the nature of the structure and the degree and method by which it was fastened to the premises."

The court found that the steelwork was not actually affixed to the ground but rather to artificial rocks which had been constructed over the site. The entire structure was able to be unhooked, demounted and removed without damage to the land. On that basis, the court refused the injunction sought by the Receivers.

3.9 "All Monies" Clause

Sellers or suppliers have also increasingly sought to rely on retention of title clauses which purport to retain title in goods delivered under a contract pending satisfaction of all or any indebtedness of the buyer to the seller. These clauses are commonly known as "all monies" or "current account" clauses. Not surprisingly, a similar controversy has arisen as to whether these clauses can be validly invoked or alternatively constitute charges. The effect of an "all monies" clause is that the seller retains title, even though part of the goods has been paid for. If the seller exercises its rights and re-sells the goods, questions then arise as to whether account should be taken of the part payment

already received by the seller or in respect of any profit made on the resale. The answer seems to depend on technical contract of law issues as to whether the contract has been repudiated. If the contract has been repudiated, therefore at an end, it appears that the seller can retain any profit made on a resale. The seller however would have to refund any part of the purchase price already paid by the buyer.

If the contract however is still on foot, then it appears that the seller can only resell so much of the goods as is necessary to discharge the balance of the outstanding price and if the seller sells any more, then it must account to the buyer for the surplus.

Depending on the circumstances of the case, recent decisions indicate that the courts are prepared to give efficacy to all monies retention of title clause.

3.10 Drafting Issues

One characteristic of retention of title clause is that it is not possible to draft an off-the-peg clause to suit all fact situations. It is also clear that enforceability of retention of title clauses depends very much on the circumstances of the particular case.

A retention of title clause should be drafted to suit:

- the type of product that is being dealt with;
- the course of conduct between the parties; and
- relevant circumstances, such as, on-sale of the products and so on.

The following matters should be considered for incorporation into a retention of title clause:

- Property in the goods is not to pass until the goods are paid for in full;
- Until the buyer pays the seller in full for the goods, the buyer holds the goods as bailee for the seller but that the buyer is authorised by the seller to sell the goods in question;
- The buyer is obliged to pay the proceeds of any on-sale into a separate account pending payment to the seller;
- The buyer must keep separate records of any on-sale of the goods owned by the seller;
- In the event of the buyer not paying for the goods in the time specified in the contract, or in other specified events of default, such as bankruptcy or the

appointment of a Receiver or a Receiver and Manager and so on, the seller is authorised to enter upon the buyer's property within business hours without notice, the take possession of the goods in question.

3.11 Conclusion

Sellers or suppliers should wherever possible, clearly mark goods which are identifiable as being the property of the seller and should also keep good records of the goods supplied. If retention of title clause is to be acted upon, speed is essential and a seller would benefit from clearly identified goods which match up with invoices.

In order to effectively take possession of the goods from the buyer, it is a tactical advantage to have the right enter the buyer's premises to recover the goods in the event of default. Without the right of entry, a seller would be trespassing. In situations where it would be anticipated that the goods would be locked away, the right of entry should permit the seller cut a lock without being liable for trespass or forcible entry. The right of the seller to enter onto the property will be a form of licence to enter.

4. Risk and Payment

As I have indicated, the retention of title clause will deal with the passing of title, but separate to this is the passing of risk.

Most distribution agreements will provide that the risk in the goods passes to the distributor when the goods are delivered. Delivery may be at the manufacturer's factory, delivery to the transport such as the ship or it may be delivery at the distributor's warehouse.

Allied to the question of risk will be who pays the cost of transportation and the imposition of any duties on the goods and whether the cost price is plus duty or excluding duty.

Obviously the distributor must take out adequate insurance protecting its risk from the time when risk in the goods passes.

The contract will also need to detail timing for payment, which can be:-

1. Prepayment under which the manufacturer will be paid prior to shipping the goods. This has the lowest risk for the manufacturer and the highest risk for the distributor but it has low transaction costs and it is administratively easy.
2. Letters of credit under which a bank will pay for the goods in exchange for documents representing the shipment of the goods that meets specified terms and conditions. The bank provides a guarantee of payment independent of the buyer and the manufacturer

is able to access the funds before payment by the buyer or prior to shipment or by using the letters of credit as a guarantee for payment to other. The obligations of the parties and the bank are covered by various international rules, uniform customs and practise for documentary credits. The risk of a letter of creditor depends on the quality and standing of the issuing bank, sovereign risk may interfere with or delay payment and the documents have to be 100% compliant to obtain the benefit of a letter of credit.

3. Payment by distributor upon receipt and inspection of goods at the warehouse of the distributor is rare.

Payment on documentary collection under which the documents relating to the export of goods are forwarded through the banking system to the distributor is the most common. The documents are released to the distributor on instructions from the manufacturer upon payment. The manufacturer's bank may buy or discount the bill and collect the proceeds in its own name. Where the manufacturer is a foreign company, often a freight forwarder or customs broker will be used to ensure that the goods are sent and payment received.

5. Termination

After the parties have entered into a valid distribution agreement one party may wish to terminate the contract before its date of expiry and without breach by the other party. This can arise:

- By notice from one party to the other;
- By action of law where a new contract supersedes a previous contract; or
- By mutual agreement.

5.1 Termination by Notice without Default

Some contracts (particularly distribution agreements) have no specific term. Where the contract is silent as to its duration, the courts will usually imply a right for either party to terminate the contract. The Courts require the terminating party to give "reasonable notice". The leading case in this on this point is *Crawford Fitting Co. v Sydney Valve & Fitting Pty Ltd* (1988) 14NSW LR 438. This was again a decision of the Court of Appeal of the Supreme Court of New South Wales. Crawford (an Ohio based company manufacturing specialised valves and fittings used in high pressure gas and liquids) appointed Sydney Valve as its distributor for products in New South Wales and Sydney Valve agreed not to sell any other products. In 1984 Crawfords gave Sydney Valve six months notice of termination. The trial judge found that a reasonable period of notice should have been 2 years.

On appeal McHugh JA considered the authorities and made the following points:

- There is no presumption of permanency in the case of an indefinite commercial agreement but if there is, the presumption it is in favour of termination and not perpetuity (*Martin-Baker Aircraft Co. Ltd v Canadian Flight Equipment Ltd* [1955] 2 QB 556). McHugh considered that a better approach rather than implying a term that a contract can be terminated by notice was that ordinarily the nature of a commercial agreement will lead to conclusion that the parties must have intended it to be terminable on notice.
- Whether a contract is terminable on reasonable notice depends on the existence of an implied term. The existence of an orally implied term is determined by the circumstances existing at the date of the contract however, the reasonableness of the period of notice depends on the circumstances existing when the notice is given. The period of notice must be sufficiently long to enable the recipient to deploy its labour and equipment in alternative employment, to carry out its commitments to bring current negotiations to fruition and wind-up the association in a business like manner.
- Some cases (such as *Witt (WA) Pty Ltd v Metters Ltd* [1967] WAR 15) considered whether the reasonableness of the period of notice had to give the recipient time to recoup expenditure incurred. In Witt's case, an agent had been appointed to develop overseas markets and to secure orders. The relationship was in place for almost 2 ½ years when the manufacturer gave 4 months notice of termination. The agent demanded 12 months notice as another year was needed to recoup its expenditure. Hale J stated that an implied term requiring reasonable notice of termination should be capable of implementation in a reasonably practicable manner and this would be difficult and virtually impossible if the manufacturer needed to form an opinion based on the profit which the plaintiff might be expected to make in the future. That is, the party needs to be able to determine what is a reasonable notice independently from the subjective requirements of the other party.

The party seeking to terminate, would know circumstances such as initial expenses and set up costs which would need to be recouped. The courts have found, for example in a distributorship agreement, the relationship between the parties must continue for long enough after giving notice of termination to enable the distributor to recoup any extraordinary expenditure or effort. These cases look at "extraordinary expenditure" as distinct from ordinary expenditure incurred in the ordinary run of business. The extraordinary effort or expenditure would be incurred with the actual or tacit authority of

the principal and therefore the principal should take this into account when determining the reasonable notice.

The courts will imply into a contract without a fixed term firstly, an implied term that the agreement will continue for a "reasonable period" and then that the agreement may be terminated on "reasonable notice". They are two distinct concepts. The "reasonable period" can be inferred from the requirement to set up the arrangement. For example, in a distributorship agreement the parties would have in mind a reasonable period after entering into the initial agreement. This period would allow distributor to be reimbursed for the initial setup costs. The term of that reasonable period would depend on what are the setup costs etc. and the extraordinary expenditure has the distributor incurred in entering into the distributorship agreement.

For example, where a distributor has to carry out extensive advertising in the principal's name, put in place a complete system of marketing, perhaps acquire new software or other branding then the period may be several years. In another case, the distributor may simply be selling a particular product as part of a line of products being sold. For example a distributor of a particular brand of chefs knife may also be selling to commercial kitchens a range of other products such as saucepans, crockery etc. The expenditure to the distributor may be minimal and therefore the "reasonable period" for the termination the distributorship would also be minimum.

The second aspect is the reasonableness of the notice itself. As stated by McHugh JA, that period would be "sufficiently long to enable the recipient to deploy his labour and equipment in alternative employment to carry out his commitments to bring negotiations to fruition and to wind up the association in a business like manner." Again the period of the reasonable notice will depend on the circumstances. In general, the more closely the distributor's business is aligned with the principal's, the longer the reasonable notice period would be. In my previous example of the sale of kitchen knives, the period within which to terminate may only be a matter of months to enable each party to locate an alternate product to sell and an alternate distributor to sell the knives and also a period within which to fulfil existing orders. However where the distributor is exclusively selling a line of product, it would need longer to replace its business.

5.2 Drafting Issues

The first drafting issue is of course to decide whether the contract should be "at will" at all. In most cases, it would be preferable to have at least a minimum term which would then remove the need to have an implied "reasonable period". A contract should have the agreed minimum term and then either an automatic rollover provision to provide that

the contract is renewed for a period such as 12 months unless either party terminates the agreement within a specified period before the rollover date or the agreement automatically rolls over. I would also recommend that the contract specifically state the period of notice for termination if the parties want the right to terminate on notice after the initial period.

5.3 Example

We recently acted for a distributor. The distributorship agreement had been negotiated by the parties without lawyers. It had been on foot for a number of years and our client had consistently performed better than the key performance indicators required. Our client was one of the best performing distributors within the network in Australia but unfortunately there was a personality conflict between the general manager of our client and the general manager of the Asia Pacific Operations of the principal. This conflict had become very personal.

The principal had required our client to repaint its premises in the livery of the product quite recently and had allowed our client to place significant orders for product for resale. The principal then purported to terminate the distributorship on one month's notice.

The distributorship agreement did not provide for a minimum term and did not provide for a minimum period of notice.

The matter ended up in court but was settled before judgment. The issues were:

- The principal had required our client to repaint in its livery quite recently before termination;
- the principal had allowed our client to lodge a large purchase order for the product and was now refusing to allow time to sell the product the subject of the order, refused to allow our client to sell the product at a discount within the notice period and refused to allow other distributors to buy product from our client. It would only allow our client to sell the product as an unauthorised distributor which meant that the period of time to sell the product would be greatly extended and our client would make a significant loss.
- The final evidence of bad faith was that the general manager of the principal had had his secretary to contact my client to find out the birthday of the general manager and then issue the notice on that date.

While there was some evidence of bad faith, the bottom line was that the contract had no period of notice. The parties ended up agreeing that one month was not sufficient notice and compensated the distributor accordingly.

5.4 Termination by Subsequent Agreement

A contract can be expressly or impliedly terminated by a subsequent agreement. Express termination is governed by the usual laws of contract requiring an agreement by both parties and consideration.

Where one party has performed the original contract and the other party has not, the performing party will give good consideration by agreeing to release the non-performing party but as the performing party has already performed its obligations under the original contract, there is no consideration from the non-performing party to release it. Accordingly, a release of a performing party by a non-performing party would need to be done by way of deed.

A more difficult position is where there is an implied termination of a contract by a subsequent agreement. Normally, the subsequent agreement would specifically state whether or not it supersedes the early agreement but in some cases, this will not be stated. It will be up to the courts to determine whether the subsequent agreement was intended to replace the earlier one or whether it is merely a variation. The courts are more likely to infer that a subsequent agreement is intended to replace an earlier one where the two documents are inconsistent.

In most commercial situations, it will be clear from the terms of the subsequent agreement whether or not it is intended to supersede the earlier one. For example in a variation to a distribution agreement, it would be most likely that a subsequent agreement would deal only with the particular items to be varied and therefore could not stand alone. It can be more difficult to determine where the subsequent agreement is a stand alone document or can be interpreted as a stand alone document.

The High Court in *Concut Pty Ltd v Worrell* (2000) 176ALR 693 considered the position whether a subsequent written employment contract superseded an earlier oral agreement. The facts were quite unusual. The employee had been employed on an oral contract for 6 years as the general manager. During that time he used his employer's equipment and materials to build his own house without the consent of the employer. Subsequently, he entered into a written contract with the employer. The employer terminated his employment without notice and then subsequently discovered that the employee had used the employer's equipment and materials to build the house.

The trial judge found that the employer had a right to terminate without notice because the employee had breached his conditions of employment by misconduct. The Court of Appeal found that the written employment contract was "a new and discrete contract of employment terminating and replacing the oral agreement". Accordingly, as the written contract was a new contract, the wrongful actions of the employer had taken place under the earlier agreement and could not be a basis for terminating the later agreement without notice.

Not surprisingly the matter went to the High Court which rejected the argument in the Court of Appeal. The High Court found that the subsequent written contract was not intended to supersede the original oral agreement. The two agreements could co-exist with the later written agreement providing more detail to the arrangements.

This case shows the importance of considering what is intended by a variation and whether a subsequent contract adequately captures all the variations required. Often in employment contracts, an employee may advance through the organisation without entering into subsequent contracts. Changes will relate to increase of salary or changes to job description without varying the underlying terms of the relationship. This may have unintentional results.

For example, if a person is employed as a trainee lawyer with a particular salary and general conditions of employment such as termination on 2 weeks notice etc, and the person remains with the firm and becomes a salaried partner, the only change to the employment relationship may be the salary and, hopefully, the job description. The period of notice for termination may not change though clearly as the person becomes older his or her ability to change careers quickly may be limited. Similarly, with the same contract, the restraint for a trainee lawyer may be much less than for a salaried partner.

Where there is a series of distribution agreements or a series of sales agreements, a subsequent agreement may supersede the terms in a previous one. The parties need to make sure each time a distribution agreement is signed or each time a sales agreement is signed, it includes all terms of the arrangement until the latter document is clearly identified as a variation of the earlier one.

6. Conclusion

A supplier or distribution agreement is a contract like all others. The parties need to negotiate and specify as clearly as possible the elements of the arrangement:-

Specify the goods being bought, identify when the product is to be paid for, identify when title passes, identify when risk passes and deal with how the arrangement can be terminated. From the seller's or manufacturer's point of view, the main issue is to ensure that title to the goods is held until payment is received. From the distributor's point of view, it is important to protect against faulty goods and to have redress either from the manufacturer or an insurer for product liability and to put in place mechanisms to ensure that the quality of the goods is consistent.