

DISTRIBUTION CONTRACT COMPENSATION CLAUSES

An article written by Mark Hamilton for Australian Vignerons Magazine

The necessity to get the appointment of overseas distributors right has been highlighted by some US and UK distributors seeking the inclusion of substantial compensation clauses in distribution agreements with Australian wineries.

Anecdotal evidence suggests that some smaller Australian wine companies are agreeing to these provisions which can be quite uncommercial and onerous. They may also be potentially void as a "penalty clause" depending upon which country's law applies.

These clauses typically seek a substantial payment of compensation upon termination of the relationship by reference to the final year's sales in, often, overseas currency irrespective of how long the relationship has run and how much notice of termination or non-renewal was given.

The compensation is payable in addition to the requirement to give a substantial period of notice of termination or non-renewal.

For example, the parties might enter into an agreement along the following lines:

Five year term with automatic five year roll-overs (that is, an evergreen contract) unless one party gives one year's notice of non-renewal prior to the expiry of the current five year term.

A 10% payment by the winery to the distributor, for example, in US dollars or UK pounds based upon the sales by the distributor of the winery's products in the last 12 months of the agreement.

The terms sought by some distributors vary, however, we are talking here of significant and potentially crippling sums of money, coupled with enormous currency risks.

This may not seem particularly significant to an Australian winery seeking to establish a new market in the US, however, it may take on significant proportions over time.

There are numerous distributors in all overseas export markets many of whom do not require compensation clauses including substantial well established distribution houses. It would therefore need to be something particularly special about a distributor and its access to the marketplace which would justify taking on a liability of this type.

There is little or no justification for these compensation clauses. The objective of a long term distribution agreement is twofold. To give security to both parties and to give the distributor a reasonable period in which to obtain a commercial return for the money and time which they have expended in establishing or developing the brand in the marketplace. This is typically considered to be five years.

The requirement under a distribution agreement to give reasonable notice of termination is based on legal principle. Hence, a requirement for a year's notice of termination before the expiry of the five year term is reasonable as it gives the distributor the opportunity to obtain a replacement agency.