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# Distribution Agreements in Australia and Germany – a comparative analysis

Trade between Australia and Germany is increasing steadily. The following article provides an introduction into the difference between German and Australian law governing distribution agreements. The aim of the article is to help legal professionals provide advice when a client is contemplating the choice of governing law for a distribution agreement, which is always important in international matters.

## I. Introduction

Australia is increasingly the focus of German and European businesses looking for new markets. These businesses are attracted by Australia's functioning infrastructure and political stability. In 2008, German businesses exported products in the value of approximately €6.6 billion to Australia and this trade is increasing. In Germany, the majority of the population lives in small or medium-sized cities. Whereas in Australia more than 11 million people, which is more than half of the population, live in five commercial centres (i.e. Sydney, Melbourne, Brisbane, Perth and Adelaide). The existence of these commercial centres is advantageous for the distribution of products and balances out the high transportation costs incurred due to geographical distance from Europe. When planning to distribute products in Australia, German companies must always consider the most suitable distribution system.

## II. Current Legal Considerations

### 1. Claim for Compensation by Commercial Agent

#### a) Germany

Pursuant to Section 89b(1) of the German Commercial Code (HGB, being *Handelsgesetzbuch*), commercial agents may have a claim for compensation at the termination of an agency agreement. This is the case when the principal receives a significant advantage through the winning of new customers or a substantial expansion of business connections with existing customers and the payment of compensation is fair and equitable. All relevant circumstances must be taken into consideration, especially any commission payments the commercial agent may already have received from trade with these customers<sup>1</sup>. A claim for compensation as set out in Section 89b(1) of the German Commercial Code, along with other provisions of the law governing commercial agents, may subject to certain disputed pre-conditions also apply to agreements with dealers<sup>2</sup> or to franchise arrangements<sup>3</sup>.

<sup>1</sup> For more information in relation to the practical consequences of the change to Section 89b(1) of the German Civil Code which came into force on 5 August 2009, please see *Semler*, BB 2009, 2327; *Thume*, BB 2009, 2490; *Steinhauer* EuZW 2009,887.

<sup>2</sup> For example, please see the following German court decisions: BGH (Bundesgerichtshof = Federal Court of Justice), 2 July 1987 – 1 ZR 188/85, NJR-RR 1998, 42; BGH, 6 October 1993 – VIII ZR 172/92, NJW-RR 1994, 99; BGH, 1 December 1993 – VIII ZR 41/93, NJW 1994, 657.

<sup>3</sup> For a more detailed discussion of the problem of applying Section 89b of the German Civil Code to franchise systems, please see *Küstner*, in *Küstner/Thume*, *Handbuch des gesamten Außendienstrechts*, Volume 2, 8<sup>th</sup> edition, chapter II, paragraphs 115 and following.

In international commercial matters, Section 92c(1) of the German Commercial Code allows for the exclusion of a claim for compensation by a distribution partner (i.e. a commercial agent or distributor), if the distribution partner acts for the business in a country which does not belong to the European Union or the European Economic Area<sup>4</sup>. This is also the case where the distribution partner operates in a country which provides for a mandatory claim similar to the claim for compensation for commercial agents.<sup>5</sup> Accordingly, if a German or Australian distribution partner of a German principal distributes exclusively in Australia then, on the basis of German law, Section 89(b)(1) of the German Commercial Code can be excluded.

*b) Australia*

Under Australian law, a mandatory claim for compensation on termination of a distribution agreement similar to the compensation claim under German law does not exist. However, distribution partners may have a claim for damages, if the distribution agreement is not terminated in accordance with the agreed notice period. This is important in circumstances where the distribution agreement does not include an express termination notice period. In these cases, Australian courts assume that the distribution agreement can only be terminated in accordance with a reasonable termination notice period. A termination notice period is considered reasonable when it enables the distribution partner to finalise pending business dealings in an orderly manner. Any further claim for damages is only available if contractually agreed on.

*c) Conclusion*

At first glance, the legal position under Australian law may seem more attractive to businesses. However, a distribution partner who does not have access to a compensation claim and is not protected by a long-term distribution agreement or termination notice period, may have little interest in long-term market development and in building a substantial distribution network. Taking this into consideration, the choice of Australian law may only be suitable if a compensation claim cannot be excluded under German law; i.e. the distribution partner also acts within the European Union or the European Economic Area.

## **2. Competition Law in Relation to Distribution Agreements**

*a) Germany*

Distribution agreements predominantly include non-competition clauses which prohibit the distribution partner of the principal from distributing competing products or acting for a competitor. Where a distribution partner is allocated a specific distribution territory under a distribution agreement, the principal is usually obliged not to appoint any further distribution partners in that distribution territory. In these circumstances, it is important to check whether the restraints on competition in the distribution agreements breach competition law. Regardless of the choice of law, Section 1 of the German Restraints on Competition Act (GWB, being *Gesetz gegen Wettbewerbsbeschränkungen*) always applies if the restraint on competition has an effect in Germany.<sup>6</sup> The same applies for any regulations pursuant to

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<sup>4</sup> For a discussion about the legitimacy of a partial exclusion where a distributor acts within as well as outside the EU or the EEA, please see *Semler* in Martinek/Semler/Habermeier, *Handbuch des Vertriebsrechts*, 2<sup>nd</sup> edition 2003, Section 15, Paragraph 55.

<sup>5</sup> OLG (Oberlandesgericht = District Court) Munich, 20 November 2002 – 7 U 5609/01, RIW 2003, 302; OLG Munich, 11 January 2002 – 23 U 4416/01, RIW 2002, 319; dissenting opinion *Kindler*, RIW 1987, 660.

<sup>6</sup> Section 130(2) of the German Restraints on Competition Act; for further discussion see *Stockmann*, in Loewenheim/Meessen/Riesenkampff, *Kartellrecht*, 2<sup>nd</sup> Edition, 2009, Section 130 of the German Restraints on Competition Act paragraphs 39 and following.

Article 101 of the Treaty on the Functioning of the European Union (TFEU)<sup>7</sup>, which is applicable when a restraint on competition can have the tendency to affect trade within the internal EU market. It may not be easy to assess this in every case, as not every agreement between German and Australian businesses restricting competition will have an effect on trade between EU Member States, even if it has an effect on the German market.<sup>8</sup> When Section 1 of the German Restraints on Competition Act and Article 101 TFEU are both applicable then Article 101 TFEU takes precedence over German law.<sup>9</sup>

The application of German or European competition law to the legal relationship between a principal and a commercial agent is problematic. A commercial agent is generally treated as a business as defined by Section 1 of the German Restraints on Competition Act<sup>10</sup>, which means that agreements between a commercial agent and a principal which restrict competition are generally subject to competition controls. An exception to this is in the area of pure commercial agent activity, where the commercial agent is obliged to fulfil the instructions and practices of the principal. In this case, the commercial agent is economically dependent on the principal, so that the commercial agent cannot be viewed as an independent business.<sup>11</sup> Agreements restricting competition which only apply to distribution itself and do not apply to the relationship between the commercial agent and the principal are therefore excluded from the scope of Section 1 of the German Restraints on Competition Act and Article 101 TFEU respectively.<sup>12</sup> The legal situation is different when a commercial agent assumes one or more considerable financial and commercial risks in relation to the distribution of the products of the principal.<sup>13</sup> In this case, the commercial agent is treated as a non-genuine commercial agent, with the result that all restraints on competition between the non-genuine commercial agent and the principal are subject to competition controls.<sup>14</sup> Common examples of this include the commercial agent assuming responsibility for the payment of shipment and warehousing costs, being liable for any damage, loss or deterioration of the products to be distributed<sup>15</sup> as well as being obliged to invest in business premises or employee training<sup>16&17</sup>.

In accordance with Section 2 of the German Restraints on Competition Act and Article 101(3) TFEU, the applicable so-called Vertical Restraints Regulation<sup>18</sup> provides exceptions to competition law.<sup>19</sup> Pursuant to this Regulation, agreements placing restraints on competition, with the exception of certain core restraints (Article 4 of the Vertical Restraints Regulation), are exempted from competition law when the market share of the supplier in the relevant

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<sup>7</sup> corresponds to Article 81 of the Treaty on European Union (in the version valid until 30 November 2009).

<sup>8</sup> For a general discussion, see *Gippini-Fournier/Mojzesowicz*, in: Loewenheim and ors. (6<sup>th</sup> Edition), Article 81(1) Treaty on European Union Paragraph 193.

<sup>9</sup> Article 3 of EU Regulation No. 1/2003 of the European Council dated 16 December 2002, Official Journal of the European Union 2003 L 1/1.

<sup>10</sup> *Zimmer*, in: Immenga/Mestmäcker, Wettbewerbsrecht GWB, 4<sup>th</sup> Edition 2007, Paragraph 1 Sub-paragraph 55.

<sup>11</sup> BGH, 15 December 1967 – KZR 6/66, GRUR 1968, 654, 658; BGH, 15 April 1986 – KVR 3/85, GRUR 1986, Paragraph 750 and following.

<sup>12</sup> This is supported by the EU Court of Justice citing the European Commission's Guidelines on Vertical Restraints (EU Regulation 2000 C 291/01); compare EU Court of Justice, 11 September 2008 – C-279/06, EuZW 2008, 668; EU Court of Justice, 14 December 2006 – C-217/05, GRUR 2007, 437.

<sup>13</sup> From 1 June 2010, pursuant to draft guidelines by the European Commission (please see footnote 20 below), three (as opposed to two) types of financial and commercial risks must be considered when assessing a distribution agreement with a commercial agent. The additional criterion to be considered is whether the commercial agent must assume risks from an additional activity which is not essential to the distribution of the products of the business; see paragraph 16 of the draft guidelines of the European Commission.

<sup>14</sup> Paragraph 15 of the Guidelines on Vertical Restraints of the European Commission (see footnote 12).

<sup>15</sup> EU Court of Justice decision dated 11 September 2008 – C-279/06, EuZW 2008, 668.

<sup>16</sup> Paragraph 16 of the Guidelines on Vertical Restraints of the European Commission (see footnote 12).

<sup>17</sup> For a detailed discussion of the criteria for assessing assumption of risk see *Nolte*, in: Langen/Bunte, Kommentar zum deutschen und europäischen Kartellrecht, Volume 2, 10<sup>th</sup> Edition, 2006, article 81, paragraph 770 and following.

<sup>18</sup> Commission Regulation (EC) No. 2790/1999 dated 22 December 1999, ABIEG 1999 L 336/21.

<sup>19</sup> For the exemption from anti-competitive agreements in the motor vehicle sector, please see Commission Regulation (EC) No. 1400/2002 dated 31 July 2001, ABIEG 2002 L 203/30, which takes precedence pursuant to Article 2(5) of the Vertical Restraints Regulation.

market does not exceed 30% (Article 3(1) of the Vertical Restraints Regulation). In the case of agreements containing exclusive supply obligations, an exemption is only possible if the market share of the buyer does not exceed 30% (Article 3(2) of the Vertical Restraints Regulation). It is anticipated that from 1 June 2010 both parties to an agreement may only be exempted from competition law, if each of the parties' market share does not exceed 30%.<sup>20</sup> Additional exemption criteria must be met in order for agreements between competitors to be exempt from competition law (see Article 2(4) of the Vertical Restraints Regulation). Further special criteria apply to restraints on competition, on manufacturing, providing, obtaining, selling or reselling products after termination of an agreement as well as restraints on members of selective distribution systems not to sell brands of particular competitors (Article 5 of the Vertical Restraints Regulation).

b) *Australia*

Distribution agreements which prohibit the distribution partner from distributing competitors' products, dictate the retail prices or set a particular distribution territory, in which the principal may not appoint an additional distribution partner, may also breach Australian competition law.

The Australian laws to protect free competition can be found in Part IV of the Trade Practices Act 1974 (Cth), in particular Sections 45, 47 and 48. The aim of these provisions is to protect and promote competition by prohibiting anti-competitive agreements, arrangements and collusion, monopolies and misuse of market position, anti-competitive mergers, retail price fixing and collusion as well as secondary boycotts which affect competition. As a commercial agent does not enter agreements in his or her own name, a commercial agent as a natural person often does not fulfil the specific elements of an offence as set out in the relevant competition regulation. However, one should note that Australian competition law governing distribution cartels generally applies to commercial agents. This applies to the commercial agent's relationship with the principal as well as to the customers as Australian competition law governs all forms of arrangements and understandings.

aa) *Exclusive Agreements*

Section 45(2) provides that a corporation may not enter any agreements, arrangements or understandings which contain an exclusionary provision or which have the purpose<sup>21</sup>, or the actual or possible<sup>22</sup> effect of a substantial restraint on competition<sup>23</sup>. Although the term "cartel" is not used, this provision contains the classic prohibition of cartel arrangements between competitors. This provision does not apply to situations where the principal and the distribution partner are not in competition with each other, i.e. a vertical arrangement exists. However, in situations in which the distribution partner is also a competitor, any possible prevention of or restraint on the supply of products or services must be examined pursuant to the relevant provision.

In addition, Section 47(1) provides that a corporation may not rely on the business method of an exclusive dealing in trade and commercial transactions. An exclusive dealing is generally defined as behaviour where the supply or the purchase of products or services is made dependent on compliance with exclusivity conditions.

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<sup>20</sup> See Article 3 of the draft regulation by the European Commission available at: [http://ec.europa.eu/competition/consultations/2009\\_vertical\\_agreements/draft\\_regulation\\_en.pdf](http://ec.europa.eu/competition/consultations/2009_vertical_agreements/draft_regulation_en.pdf)

<sup>21</sup> *News Limited v South Sydney District Rugby League Football Club Ltd* [2003] 200 ALR 157.

<sup>22</sup> *Tillmanns Butcheries Pty Limited v Australian Meat Industry Employees' Union* [1979] 42 FLR 331.

<sup>23</sup> *ASX Operations Pty Limited v Pont Data Australia* [1990] 27 FCR 460, 470.

## bb) Conditions

Section 47(2) describes the most important situation of vertical restraints on competition in competition law, in which a corporation offers or supplies a person with goods or services or provides or supplies discounts or favourable payment terms on the condition that the person does not purchase, or only purchases a limited amount of the goods or services of a competitor. Pursuant to Section 47(13), a condition includes any direct or indirect condition, even if the existence or nature of the condition can only be ascertained by inference. The question whether the condition can be legally enforced is irrelevant to the assessment of a condition. The condition does not have to have been forced on the distribution partner by the principal, but can also have been a suggestion by the distribution partner or a third party. The focus of the legislation is on the link between the supply and the condition and not on the source or origin of the condition.<sup>24</sup>

Although the term “condition” has been construed widely by the Australian courts, the simple fact that a competitor’s products or services are excluded as a consequence of the parties’ behaviour does not automatically mean that the supply was excluded on the basis of an unlawful condition.<sup>25</sup>

It is also important to note that not only businesses supplying goods or services under a condition, or refusing to supply goods or services due to a distribution partner not accepting an anti-competitive restraint, can breach the prohibition of restraints on competition in Section 47.<sup>26</sup> A distribution partner can also breach Section 47 if he or she purchases products or services from the principal under the condition, that the principal does not supply any competitors of the distribution partner, or if the distribution partner refuses to purchase goods or services from the principal, because the principal insists on supplying the distribution partner’s competitor.<sup>27</sup>

In order for behaviour to be assessed as breaching Section 47 it must have the effect of substantially lessening competition.<sup>28</sup> The term “substantial” is undefined and can include any effect from massive to minimal or simply a more than nominal limitation. Australian courts have defined the meaning of the term on a case by case basis<sup>29</sup>, with the effect that this requirement must be tested in each case.

Exclusive distribution agreements, which either prohibit the principal to appoint other distribution partners in the relevant territory or prohibit the distribution partner from offering competitors’ goods or services, may therefore justify a restraint on competition. Australian law also assesses the market share in the relevant market sector in order to establish whether an exclusive agreement has anti-competitive effects. Other factors are also relevant, such as the market entry threshold and how difficult it is for customers to buy competitor’s products or to find competitors of other distribution partners. It is therefore especially important to examine exclusive distribution agreements in niche markets very carefully.

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<sup>24</sup> *Re Ku-ring-gai Co-operative Building Society (Nr. 12) Ltd* [1978] 36 FLR 134, 167.

<sup>25</sup> *Monroe Topple & Associates Pty Limited v The Institute of Chartered Accountants in Australia* [2002] FCAFC 197. In this case, the respondent changed the course material for the qualifying examination to become a member of the Institute, with the consequence that the claimant was excluded from supplying the course material. The court held that the exclusion of the claimant, who could not supply the new course material, was just a consequence and not the purpose of the change and was therefore lawful.

<sup>26</sup> Section 47(2) of the Trade Practices Act 1974.

<sup>27</sup> Section 47(3) of the Trade Practices Act 1974.

<sup>28</sup> This element of the offence is similar to the requirement of appreciability under German and European law set out in Section 1 of the German Restraints on Competition Act and Article 101 TFEU (= Article 81 of the amended Treaty on European Union); see detailed discussion by *Nordemann*, in Loewenheim and others (see footnote 6), Section 1 of the German Restraints on Competition Act Paragraph 141 and following.

<sup>29</sup> *Radio 2UE Sydney Pty Limited v Stereo FM Pty Limited* [1982] 62 FLR 437; *Dandy Power Equipment Pty Limited v Mercury Marine Pty Limited* [1982] 64 FLR 238.

cc) Third Line Forcing

Sections 47(6) and (7) also prohibit so-called “third line forcing”. This refers to behaviour whereby a business supplies a customer under the condition that the customer also purchases products or services from a third party. Competition law is relevant in particular when manufacturers of two complementing products with the same target customer base together seek a distribution partner and make the agreement with the distribution partner conditional on the distribution partner agreeing to distribute both manufacturers’ products. However, these provisions are only applicable if the businesses are separate corporate entities. Businesses belonging to the same corporate group are exempt from this prohibition.

dd) Price Fixing

Section 48 prohibits price fixing and collusion. The scope of this prohibition includes not only express contractual provisions prohibiting a distribution partner from offering products or services for sale at a price which is lower than a particular price fixed by the principal, but also includes any behaviour which could influence a distribution partner not to offer products or services for sale at a price lower than the price suggested by the principal. Even the stating of recommended retail prices could be seen as anti-competitive price fixing.

ee) Legal Consequences

The law provides for breaches to be punished by requiring not only compensation payments but also penalty payments, often in the millions of dollars. In a case by the Trade Practices Commission, the Federal Court of Australia held that “the penalty should constitute a real punishment proportionate to the deliberation with which the defendant contravened the provisions of the Act. It should be sufficiently high to have a deterrent quality, and it should be kept in mind that the Act operates in a commercial environment where deterrents of those minded to contravene its provisions is not likely to be achieved by penalties which are not realistic.”<sup>30</sup>

c) Conclusion

Even though the general approaches and aims of both German and Australian competition law are comparatively similar, substantial differences in relation to detailed situations exist. A business can therefore not assume that any restraints on competition which are legal in Germany will be assessed as so in Australia. It is therefore recommended that before entering a distribution agreement the relevant German and Australian competition provisions are considered on a case by case basis.

### 3. Retention of Title

a) Germany

Section 449 of the German Civil Code (BGB, being *Bürgerliches Gesetzbuch*) governs the legal consequences of basic retention of title. Basic retention of title clauses as well as expanded or extended retention of title clauses are commonly included in distribution agreements. The validity of such clauses in general terms and conditions of trade has also been upheld at the highest instance.<sup>31</sup> However, the validity of a so-called reverse retention of title clause in general terms and conditions of trade has not yet been decided. A reverse

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<sup>30</sup> *TPC v Stihl Chain Saws (Aust) Pty Limited* [1978] ATPA 40-091.

<sup>31</sup> BGH, 9 February 1994 – VIII ZR 176/92, NJW1994, 1154 (expanded retention of title); BGH, 20 March 1985 – VIII ZR 342/83, NJW 1985, 1836 (extended retention of title).

retention of title clause provides that ownership of the goods sold only passes to the customer after all the supplier's requests for payments or other requirements have been met by the customer and any of the businesses related to the customer.<sup>32</sup>

In international commercial dealings, the passing of ownership is governed by the law of the country in which the goods are located (Article 43(1) of the Introductory Act to the German Civil Code (EGBGB, being *Einführungsgesetz zum Bürgerlichen Gesetzbuch*)). Pursuant to this, the requirements and material effects of a retention of title clause are governed by the law of the destination country from the moment the goods have crossed the border.<sup>33</sup> This means that if a German supplier sells goods to an Australian distribution partner subject to a retention of title clause and the goods are located in Australia at the time when ownership passes to the distribution partner, then the validity of the retention of title clause is determined solely by Australian law.

#### b) *Australia*

Basic and extended retention of title clauses also exist in Australian law. As in Germany, basic retention of title is unproblematic, as long as an agreement exists between the parties, which is usually in the form of general terms and conditions of trade. As Australian law does not contain provisions similar to Sections 946 and following of the German Civil Code, a valid retention of title clause does not have any effect if the goods sold have lost their separate identity. An owner of several different goods which become part of a new larger item therefore does not become the owner or part-owner of the larger item. The only owner of the larger item is the manufacturer. In addition, the Sale of Goods Acts of the different States and Territories contain provisions similar to Sections 932 and following of the German Civil Code which provide that a bona fide customer can obtain ownership of goods sold despite the existence of a valid retention of title clause. This applies in particular to cases where the distribution partner intends to resell the goods which were delivered subject to a retention of title clause. In these cases, the retention of title clause is often construed in such a way that the retention of title clause is abandoned when the distribution partner resells the products in the normal course of business. However, if the resale was explicitly agreed (e.g. in the general terms and conditions of trade) the supplier can have a claim on the proceeds of the sale. This is made possible through an assignment and creation of a trust which has the effect that the distribution partner receives the proceeds of sale on trust for the supplier. This, however, only has practical application in cases where the customers of the distribution partner have outstanding invoices to pay and the supplier demands payment to itself, as the combining of a payment received in the general account of the distribution partner with other monies makes it impossible to trace the payment and so demonstrate that a particular amount is held on trust for the supplier.

#### c) *Conclusion*

In legal transactions between Australia and Germany, agreements containing basic or extended retention of title clauses are possible. It is doubtful, however, whether a retention of title clause is sufficient to support claims of German suppliers against its distribution partners in Australia. When one considers that the immense geographical distance generally makes obtaining access to goods extremely difficult, it may be more prudent to choose another way of securing possible claims, such as a bank guarantee.

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<sup>32</sup> A retention of title provision providing that ownership only passes to the customer after all the requests for payment or other requirements of the supplier and of any businesses related to the supplier have been met by the buyer is not legal pursuant to Section 449(3) of the German Civil Code.

<sup>33</sup> *Thorn*, in: Palandt, BGB, 69<sup>th</sup> Edition 2010, Article 43 EGBGB Paragraph 8.

#### **4. Contractual Penalty Clauses**

##### *a) Germany*

A contractual penalty clause pursuant to Section 339 of the German Civil Code is a common tool for situations where the fulfilment of contractual obligations is extremely important for one of the parties. Contractual penalty clauses are generally permissible under German law. However, contractual penalty clauses between merchants which are found in general terms and conditions of trade can be problematic. A large number of court decisions at the highest instance must be considered when assessing or drafting a contractual penalty clause. For example, the amount of the contractual penalty must be aligned with the expected damages amount<sup>34</sup>, must be reasonable in consideration of the seriousness of the breach of contractual obligation<sup>35</sup> and may not exceed 5% of the net value of the transaction.<sup>36</sup> In relation to agreements with commercial agents, penalties of €250 for every failure to forward on the address of a party to the contract<sup>37</sup> as well as penalties of €10,000 for the headhunting of employees<sup>38</sup> have been held to be consistent with Section 307 of the German Civil Code.

##### *b) Australia*

Contractual penalty clauses to deal with breaches of obligations of a distribution agreement are considered a breach of the public order in Australian law and are therefore not enforceable by the courts. The common practice in Australia is to agree on an amount of liquidated damages instead of a contractual penalty. It is important to note that liquidated damages may only have the purpose of replacing an otherwise complicated calculation of damages with a simplified damages estimate. A party wishing to claim liquidated damages must be in a position to demonstrate that damage has occurred and that the calculation method chosen states a link between the breach of contract and the possible damage.

##### *c) Conclusion*

Only in very rare cases will the decision as to whether Australian or German law should be the applicable law for a distribution agreement hinge on whether a contractual penalty clause is required. However, this is further proof that these legal systems do contain differences in relation to many detailed situations.

#### **5. Applicable Law**

##### *a) Germany*

Pursuant to Article 4(1)(f) of the Regulation (EC) No. 593/2008 (Rome I), the applicable law for any distribution agreement entered into after 17 December 2009 is the law of the country in which the distribution partner is normally located. Distribution agreements entered into before 17 December 2009 continue to be governed by Article 28(1) of the Introductory Act to the German Civil Code, whereby the applicable law is the law of the country with which the distribution agreement has the closest ties. With distribution agreements, the typical performance of each individual agreement determines the applicable law (Article 28(2) of the

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<sup>34</sup> BGH, 3 April 1998 – V ZR 6/97, NJW 1998, 2600, 2602. If a contractual penalty clause sets the same penalty amount for the breach of different contractual obligations by the distributor without taking into account the type, nature and extent of the breach, then the clause is only valid if the penalty amount is still reasonable for the most common and smallest breach; BGH, 7 May 1997 – VIII ZR 349/96, NJW 1997, 3233.

<sup>35</sup> BGH, 21 March 1990 – VIII ZR 196/89, DB 1990, 1323. It is also a requirement for the validity of a contractual penalty clause in general terms and conditions of trade that it relates to a breach by a party to the agreement.

<sup>36</sup> BGH, 23 January 2003 – VII ZR 210/01, NJW 2003, 1805.

<sup>37</sup> BGH, 28 January 1993 – I ZR 294/90, NJW 1993, 1786, 1787 and following.

<sup>38</sup> OLG Munich, 26 January 1994 – 7 U 5841/93, NJW-RR 1994, 867, 868.



Introductory Act to the German Civil Code). In a commercial agency agreement, a commercial agent is generally responsible for performance of the contract, so according to Article 28(2)(2) of the Introductory Act to the German Civil Code, the location of the commercial agent's business is relevant.<sup>39</sup> The same applies to dealership agreements<sup>40</sup>. With the application of Rome I, there has therefore been a change to the previous application of the Introductory Act of the German Civil Code to commercial agency agreements and dealership agreements which is not linked to the German Civil Code. However, something different applies to the question of applicable law for franchise agreements. Pursuant to Article 28 of the Introductory Act of the German Civil Code, it is again decisive for the question of applicable law which party to the contract is responsible for the performance of the contract. This may be assessed differently in franchises dealing with goods and franchises dealing with services.<sup>41</sup> Pursuant to Article 4(1)(e) of Rome I, the relevant location is now always that of the usual residence of the franchisee.

Pursuant to Article 3(1) of Rome I, German law allows for the distribution agreement to fall under the applicable law agreed upon by the parties to the agreement.<sup>42</sup> This does not, however, allow circumvention of any regulation governing the mandatory applicable law in cases where no applicable law has been agreed on (see Article 4(3) of Rome I). This has a bearing on questions concerning competition and cartels in distribution agreements. If the main office of the distribution partner is located in Australia, Australian law must still be considered when examining the legal situation, even when the agreed on applicable law is German law.

#### b) *Australia*

The Australian legal system, which is based on common law<sup>43</sup>, assumes that personal autonomy and freedom of contract are attributes of a free society. Freedom of contract in this context does not merely mean the right to enter into a contract but also the right to determine the content of the provisions. This includes, amongst others, the choice of applicable law. As a result, pursuant to Australian law, an agreement is governed by the law chosen by the parties as the applicable law. If no explicit choice of applicable law was made in a contract, the intentions of the parties should be inferred objectively by examining the other clauses in the contract or the circumstances in which the contract was made.

The categorical statement by Lord Atkin in a decision from 1937 that an explicit choice of applicable law by the parties is final and binding<sup>44</sup> was modified shortly afterwards in a further decision by the Privy Council of the House of Lords<sup>45</sup>. In this decision, with Lord Atkin assenting, the court held that the choice of applicable law, although generally a matter of choice for the parties, must be legal and made in good faith and must not breach public order to be valid.

Although decisions by the Privy Council have not been binding on Australian law for more than 30 years, the English position is still accepted in Australia<sup>46</sup> insofar as the choice of applicable law is not obviously improper. It is important to note that, pursuant to Australian

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<sup>39</sup> BGH, 12 May 1993 – VIII ZR 110/92, NJW 1993, 2753, 2754.

<sup>40</sup> OLG Duesseldorf, 11 July 1996 – 6 U 152/95, NJW-RR 1997, 822.

<sup>41</sup> Please see *Martiny*, in MüKo/Bgb, 4th Edition 2006, Article 28 EGBGB, Paragraph 230.

<sup>42</sup> In relation to the admissibility of provisions setting applicable law in general terms and conditions, see *Kindler*, in: Ebenroth/Boujong/Joost/Strohn, HGB, 2<sup>nd</sup> edition 2008, Paragraph 92(c)(6) and following.

<sup>43</sup> *Printing and Numerical Registering Company v Sampson* [1875] LR 19 Eq 462,465.

<sup>44</sup> *Rex v Trustee for, etc. Bondholders A.-G* [1937] A.C. 500, 529.

<sup>45</sup> *Vita Food Products Incorporated v Unus Shipping Co. Limited* [1939] A.C. 277, 290.

<sup>46</sup> *AKAI Pty Ltd v Peoples Insurance Co Limited* [1996] HCA 39; *Garsec v His Majesty the Sultan of Brunei* [2008] NSWCA 211; *Ace Insurance Ltd v Moose Enterprise Pty Ltd* [2009] NSWSC 724.

law, the choice of a foreign law as the applicable law cannot lead to the exclusion of mandatory Australian provisions.

c) *Conclusion*

Both German and Australian law generally allow companies and distribution partners to choose which law is applicable to their distribution relationship.

## 6. Jurisdiction

a) *Germany*

The legitimacy of a mutually agreed place of jurisdiction is governed by Article 23 of the Council Regulation (EC) No 44/2001 if one of the parties to the contract is domiciled in an EU member state. Pursuant to this regulation, an agreement in regards to the place of jurisdiction must be made in writing or, alternatively, orally with a subsequent written confirmation. This is the case even where the agreed place of jurisdiction is Germany. Section 38 of the German Code of Civil Procedure does not require the agreement to be made in any particular form.

However, in proceedings concerned with the enforcement of a judgement by a court of the EU member state in whose jurisdiction the judgement has been or is to be enforced, a choice of place of jurisdiction is not possible (see Article 23(5) as well as Article 22(5) of the Council Regulation (EC) No 44/2001).

b) *Australia*

Under Australian law, the principle of freedom of contract generally includes the right of the parties to make an agreement in relation to the place of jurisdiction. However, an agreement in relation to the place of jurisdiction normally only establishes an additional and not an exclusive place of jurisdiction. On the basis of an established Australian legal principle, parties to an agreement cannot exclude the jurisdiction of a court by agreement.<sup>47</sup> The main aim of this principle is to prohibit agreements which essentially exclude disputes from the jurisdiction of courts. An agreement in relation to a place of jurisdiction is therefore not accepted by Australian courts per se, but must withstand examination by the courts. In this regard it must be noted that Australia is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards dated 10 June 1958 and has implemented the provisions with federal legislation<sup>48</sup>. A lawful agreement in regard to place of jurisdiction therefore allows for a dispute to be withdrawn from the jurisdiction of the courts, as the party which relies on the agreement in relation to place of jurisdiction has a legal right to a stay of proceedings.

In addition, Australian courts<sup>49</sup> make use of the “forum non conveniens” principle<sup>50</sup> found in private international law. Accordingly, Australian courts can reject its jurisdiction in a matter,

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<sup>47</sup> *Scott v Avery* [1855-1856] 5 HLC 811, 845.

<sup>48</sup> International Arbitration Act 1974 (Cth).

<sup>49</sup> Australia has State and Territory courts as well as federal courts. State and Territory courts hear matters which do not involve the application of federal law. Unlike German courts, State and Territory courts and federal courts are not part of a hierarchical structure, with the exception of the High Court of Australia which is the highest court in the country. In a dispute between a principal and a distribution partner over questions of contract and competition law, it would theoretically be possible to take legal action in a federal as well as a State or Territory court. However, for reasons of procedural efficiency, the cross-vesting legislation enables the federal as well as State or Territory courts to hear cases in which one aspect of the dispute involves both federal and State or Territory law. In these cases, the claimant can choose whether to institute legal proceedings in a federal or State or Territory court.

<sup>50</sup> This principle does not apply within the scope of the Council Regulation (EC) No. 44/2001; see EU Court of Justice decision of 1 March 2008 – C-281/02, EuZW 2005, 345, 348 = RIW 2005, 292.

despite a contrary agreement in relation to place of jurisdiction, if the Australian court is of the view that the courts of another country are more appropriate to determine the proceedings. In doing so, Australian courts apply the “clearly inappropriate forum test”, whereas English courts apply the “clearly more appropriate forum” test. This means that an Australian court cannot reject its jurisdiction because another court may be more appropriate to determine the proceedings, but only when the relevant court is clearly inappropriate to make a judgement in the matter. However, the fact that the parties chose a foreign jurisdiction is not sufficient to make an Australian court a “clearly inappropriate forum”.

### c) *Conclusion*

Distribution agreements between German and Australian parties often include an agreement to refer a dispute to arbitration, as arbitration courts are seen to have more subject matter expertise and arbitration proceedings are generally completed faster than judicial proceedings. In Germany, the recognition of foreign arbitration decisions is governed by Section 1061(1) of the German Code of Civil Procedure and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards dated 10 June 1958, to which both Australia and Germany are parties. In Australia, the recognition and enforcement of arbitration decisions is governed by Section 8 of the International Arbitration Act 1974 (Cth).

In making a decision about jurisdiction, the crucial considerations are the higher expertise of the chosen court in relation to the applicable law as well as, in particular, the possibility of the writ of execution being enforced. It is important to consider that the enforcement of Australian writs of execution in German law requires that so-called “*exequatur*” proceedings pursuant to Section 328 of the German Code of Civil Procedure are conducted<sup>51</sup> before a writ can be enforced and so further delaying the matter. This demonstrates that the choice of jurisdiction should involve a consideration not only of the greater expertise of the applicable law but, in particular, the enforceability of the relevant judgement.

### III. Summary

The legal considerations and provisions to be considered when drafting of distribution agreements discussed above demonstrate noticeable fundamental differences between Australian and German law. Although the goals of Australian and German competition law are similar, there can be important differences in the details and therefore careful research is required in each case. To determine whether German or Australian law is applicable to a distribution agreement, one must take into consideration the main points of the part of the relationship between the distributor and the principal which are the subject of the dispute. It is therefore not prudent to advise German businesses to choose German law in every case, such as in matters dealing with a claim for compensation by a commercial agent. However, consideration should also be given as to whether the potential advantages which may flow from choosing Australian law justify the additional administrative work required by a German company to comply with the Australian legal requirements. Other factors, such as cost and duration of litigation, the nature of a claim and the anticipated place of enforcement of a future judgement must be carefully considered in view of the fact that Australian courts may refuse to hear a matter if the court is not in a position to have its judgement enforced. In contrast, German judgements requiring an Australian distribution partner to make a payment are generally easily enforceable in Australia.<sup>52</sup> However, a German judgement requiring a

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<sup>51</sup> See detailed discussion by *Geimer*, in: *Zöller*, ZPO, 28<sup>th</sup> edition 2010, paragraph 328, section 1 and following.

<sup>52</sup> *Taylor v Begg* [1932] NZLR 286 sets the common law principle that a foreign judgement in an action against a person for payment of an amount must state a fixed or at least easily calculable amount in order to be enforceable. The federal *Foreign Judgements Act 1991 (Cth)* deals with the enforcement of money judgements in section 6(2).

distribution partner to refrain from a particular behaviour in Australia is not of much value as it may not be enforceable in Germany or Australia<sup>53</sup>.

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<sup>53</sup> There is no law in Australia governing the enforcement of non-monetary judgements, except for divorce decrees. However, there are some non-monetary judgements in matters where there is a dispute over ownership of a thing that are enforceable, e.g. an action for recovery of property.