



THE LEGAL INSIDER of Mr. Alain P. Lecours

PRODUCT PLACEMENT IN CANADA

The Distribution Contract and Territorial Exclusivity

A manufacturer must often call upon a middleman, a distributor for example, in order to market his product. When negotiating such a contract, the parties must consider the pertinence and necessity of granting exclusivity. An exclusivity clause implies territorial and temporal limitations to the granted exclusivity. Otherwise, the clause would be senseless (unless the parties agree upon worldwide exclusivity – a rare occurrence indeed!)

The manufacturer takes a risk whenever it grants to another person the exclusive rights to market his product on a given territory and for a given time. Indeed, its business then becomes dependent upon the distributor in regard to the product's success (i.e. sales volume). Furthermore, even if the distributor's performances are not satisfactory, the manufacturer could not, as a rule, take away the other contracting party's exclusive rights.

When a product has yet to become known on the market, the distributor must invest an important amount of time and financial resources to develop the product's reputation and market positioning. Thus, exclusive rights are a major motivator for a distributor which must market a product he does not own and that has little notoriety yet. Indeed, every product requires some time between its introduction to the market and commercial success. The commercialization efforts accomplished before a product becomes profitable constitute a major investment. In consequence, a distributor which invests his resources in such an endeavor wishes to insure he will partake in future benefits. Without the guarantee of exclusive rights over a given territory, the risks related to a product's marketing could become too important for a distributor to invest himself in that undertaking.

When a manufacturer considers granting exclusive rights over an area, he must know that many different contractual tools are at his disposition in order to establish, with his distributor, a fair and profitable relationship for both parties. During the drafting of such contracts, two important aspects must be assessed: the territory's performance and the exceptions to the exclusive rights.

Performance

In a distribution contract, performance must be deemed condition in exchange of which exclusive rights are granted. In practice, this means that the distributor shall only retain exclusive rights over the granted territory as long as he continues to meet or exceed the performance objectives set out in the contract. The parties should accordingly negotiate reasonable objectives. For when the objectives are not met, presuming no fault on the manufacturer's part, the contract could provide the following mechanisms:

1. The possibility of reducing the territory exclusively granted; or
2. The possibility of withdrawing the exclusive rights before the end of the contract, while maintaining the rights to distribution (which would become non-exclusive) ; or
3. The possibility of canceling the contract before its term, with or without payment of an indemnity to the distributor for the loss of goodwill.

Exception to exclusivity

It is possible for the two parties to provide for certain circumstances in which the sale of the product would escape the exclusivity granted to the distributor. During the negotiation of the distribution contract, the parties must be able to identify the problematic situations that could rear up their head. For example, a manufacturer and a distributor should consider the following situations:

1. The possibility that a client would do business within different territories but centralize his purchasing within a single region (which could be within the exclusive territory or not);
2. Internet sales, which by definition ignore territorial concerns;
3. The possibility that a client would prefer to deal directly with the manufacturer with no intermediary;

In such cases, as well as in any analogous situation, potentially conflicting occurrences must be addressed prior to the conclusion of the exclusive contract. In order to avoid future discord, the parties must define from the beginning of their relationship whether these problematic situations shall constitute contractual exceptions to the exclusive rights to be granted.

Conclusion

In conclusion, the distribution contract must be fair to both parties so that they each can profit. In practical (non-legal) terms, the distribution contract presupposes a partnership. The negotiations must be approached from this angle. Furthermore, before entering a binding agreement, it is equally important to consider the difficulties that could arise during the contract or at its end. Otherwise, the relationship between manufacturer and distributor shall be both brief and shaky.

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