



THE LEGAL INSIDER

of Mr. Alain P. Lecours

COMMERCIAL LAW

The Distribution Contract and Product Goodwill

At the outcome of a distribution contract, the goodwill acquired by a product can have a large value. Indeed, a distributor that invests time and financial resources into the development, reputation, and marketing of a new product usually finds that his efforts are rewarded by increased goodwill toward the product, and thus increased sales turnover for the distributor. However, who shall benefit from the product's goodwill when the distribution contract will end?

The answer: the goodwill reverts to the product's manufacturer. Indeed, goodwill is usually attached to the product rather than to the distributor (except in cases where the product's trademark belongs to the distributor, or when goodwill is not dissociable from the distributor). Hence, the results of the distributor's numerous efforts can escape him when the distribution contract comes to an end or is cancelled.

In order to protect the distributor from the eventual loss of goodwill, the distribution contract can provide for payment of a compensating indemnity at the end of the contract. However, manufacturers are not always satisfied with such a solution, are consequently are not generally well disposed toward the insertion of such a clause in the distribution contract.

Nonetheless, if both parties consent to an indemnity clause, their negotiation should consider the following variables for the determination of the indemnity's value:

1. The duration of the distribution contract;
2. The notoriety of the product at the beginning of the distribution contract;
3. The publicity and marketing costs that shall be supported by the distributor;
4. The publicity and marketing costs that shall be assumed by the manufacturer;
5. The increased in goodwill that shall be accrued by the product;

The length of distribution contract could be a determining factor in the manufacturer's decision to grant or not to grant an indemnity to the distributor at the end of the contract. It could indeed be very onerous for the manufacturer if he were to pay multiple successive indemnities because he was forced to change distributors many times over a short period. Furthermore, if the distributor were only to market the product for a short time, the value of the increase in goodwill would be proportionately reduced.

The distributor should also consider the following elements:

1. Is he granted exclusivity over a precise territory by his contract with the manufacturer? And:
2. Does his contract with the manufacturer have a definite or indefinite duration?

When the contract does not stipulate a definite time-length, the manufacturer can rescind the contract at any time, simply by sending a notice, and thus removing the distributor's right to distribute the product. Consequently, the previous two criteria must be duly considered before the distributor starts investing his efforts and energies in the marketing of a new product or trademark that does not belong to him.

In any case, it is always preferable for the distributor to envisage these various issues before accepting to contribute his time, efforts, and money in marketing costs so as to bring notoriety to a product or trademark unknown to the public. Before thusly committing himself and investing one's resources, it is often desirable to consult one's legal advisor.

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