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Key Distribution Considerations: Overview (Canada)

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A Practice Note providing an overview of key issues for foreign counsel of overseas manufacturers or suppliers of goods to consider when entering into distribution arrangements in Canada, including applicable laws and regulations, important considerations for appointing a distributor, key provisions in distribution agreements, and termination considerations.

Distribution arrangements are a commonly used vehicle for the importation and sale of a broad variety of goods and services in Canada, and can offer many benefits to a foreign supplier, particularly where a local distributor with knowledge of local laws, the local market, and industry conditions and customs is engaged.

However, distribution arrangements are not without risk. A foreign supplier entering the Canadian market either directly or by engaging a local distributor must consider and ensure compliance with key legal and regulatory requirements, including applicable franchise, employment, competition, consumer protection, and product liability considerations, among others.

This Note discusses:

- Key legal and regulatory requirements governing the distribution of goods in Canada, including:
  - general legal framework;
  - legal formalities;
  - tax requirements;
  - competition laws; and
  - product regulatory requirements and product liability laws.
- Important considerations for appointing a distributor and structuring the distribution relationship in Canada, including:
  - types of distributorships;
  - relationship of the parties;
  - import requirements;
  - intellectual property (IP) issues; and
  - online sales considerations.
- Key provisions in the distribution agreement.
- Issues related to termination of the distribution relationship in Canada.

Governing Legislation and Regulation

Legal Framework

In Canada, distribution arrangements are governed by general contract law principles. To be enforceable, a distribution agreement must meet the standard requirements for the enforceability of commercial contracts. Provided the basic tenants of contract law (offer, acceptance, and consideration) are satisfied, parties can set the terms that govern their relationship.

All contracts executed in Canada are also subject to the common law duty of good faith and honest performance. In certain circumstances, distribution agreements may be classified as accidental franchises if the framework of the agreement includes one or more of the elements of a classic franchise structure (see Franchise Law Considerations). Franchise agreements are also subject to the statutory duty of fair dealing.

In the Province of Québec, good faith is a principle enshrined in Civil Code of Québec S.Q. 1991, c. 64

(CCQ) that applies to all contractual relationships and can take:

- An active form, where it can impose positive obligations in the formation, performance, and termination of contracts.
- A passive form, where it can be applied to limit contractual rights to what is reasonable in a particular relationship or dispute.

The CCQ allows courts to intervene in contractual disputes to ensure parties are executing the terms of the contract in an equitable manner. Depending on the circumstances, this can include imposing substantive implied obligations on the parties beyond the written terms of the contract such as:

- A duty to inform.
- A duty to cooperate and collaborate.
- A duty of loyalty.
- A duty to respect the other party's reasonable expectations.
- A duty to treat parties in similar situations equally.

Québec courts have applied these implied duties to sanction inappropriate conduct by one party, even where the agreement did not expressly prohibit the specific conduct.

In addition to considerations of good faith, there can be certain federal, provincial, and territorial laws relevant to distribution arrangements, including:

- Competition laws under Competition Act, R.S.C. 1985, c. C-34. particularly, relating to:
  - refusals to supply (sections 75 and 84);
  - resale price maintenance (section 76);
  - exclusive dealing, tied selling, and market restrictions (section 77);
  - abuse of dominance (sections 78 and 79); and
  - misleading representations and deceptive advertisement practices (section 74.01).
- Federal laws relating to mandatory safety and labelling requirements for general consumer products under Canada Consumer Product Safety Act, S.C. 2010, c. 21 (CCPSA) and Consumer Packaging and Labelling Act, R.S.C. 1985, c. C-38.
- Provincial consumer protection laws, which impose mandatory implied warranties for consumer sales that a seller (and, in Québec, a manufacturer) cannot disclaim.
- Federal and provincial privacy and data security laws, if any party collects personal information of consumers.
- Provincial franchise laws, if the relationship is classified as a franchise at law (see Franchise Law Considerations).
- Federal laws that relate to the importation of the distributed goods, including laws related to import filings and payment of duties.
- Commercial contract laws that can affect the parties' rights and obligations or individual orders placed under the distribution agreement, including:
  - sale of goods legislation of the province or territory and for Québec, the CCQ; or
  - the International Sale of Goods Contracts Convention Act, S.C. 1991, c-13, which adopted the United Nations Convention on Contracts for the International Sale of Goods (CISG). The act governs sale of goods transactions between Canadian companies and companies in other countries that have ratified the CISG.

Certain regulated industries (for example, automotive, food and beverage, and pharmaceuticals) must also comply with additional laws specifically governing their industries.

Legal Formalities

There are no registration, licensing, or disclosure requirements or other particular formalities required for the formation or execution of distribution agreements in Canada. Distribution agreements need not be notarized or filed with any governing body.

Language Requirements

Canada has two official languages, English and French, except for Québec, where the official province language is only French. Businesses operating in a province other than Québec can operate in either language. Businesses operating or intending to operate in Québec must comply with Charter of the French Language, CQLR, C-11 (CFL), which, among other obligations, establishes:

- French as the language of commerce and business.
- The right of employers to carry on their activities in French.

- The right of consumers and the public to be informed and served in French.

Recent CFL amendments have imposed more onerous language requirements on businesses operating in Québec, including granting individuals a private right of action to enforce and seek damages for certain breaches of the CFL.

For more information on French language laws, see Practice Note, French Language Laws: Overview (Canada).

Tax Requirements

Taxation of Non-Residents

Depending on the business structure selected by a foreign supplier selling goods in Canada, different taxes can apply on its income.

Canada's domestic tax legislation taxes Canadian residents on their worldwide income. Similarly, any non-resident person carrying on business in Canada is subject to Canadian income tax on the business profits associated with that Canadian business (subject to reduction under an applicable tax treaty).

The statutory definition for carrying on business in Canada for Canadian income tax purposes includes:

- Soliciting orders.
- Offering anything for sale in Canada through an agent or servant, regardless of whether the transaction is to be completed inside Canada.

A foreign supplier can be considered to be carrying on business in Canada pursuant to common law principles. The relevant factors for this determination include whether:

- The contract is made in Canada.
- The profit-producing operations of the foreign supplier are in Canada.
- The place of delivery is Canada.
- The payment is made in Canada.
- An inventory of goods is kept in Canada.

However, under most of Canada's tax treaties, the business profits of a foreign supplier are only taxable in Canada if these profits are attributable to a permanent establishment of the foreign supplier in Canada. A permanent establishment is generally a fixed place of business. In certain circumstances, a foreign supplier can have a deemed permanent establishment in Canada. Accordingly, depending on the circumstances, a foreign supplier entering arrangements with Canadian distributors can fall within the Canadian tax system.

A thorough review of Canadian legislation pertaining to the selected structure and effect of any tax treaties entered and ratified by Canada with the foreign supplier's jurisdiction is advisable before entering into a distribution agreement and critical to determining what taxes apply.

Canadian Distributors

Generally, a foreign entity resident in a country with which Canada has a tax treaty can have an independent sales representative organization in Canada by way of distribution arrangements or can enter sales contracts to supply goods or services to Canadians without being liable for Canadian income tax on its profits from those sales.

In these cases, care must be taken to ensure that the foreign entity does not maintain a permanent establishment in Canada. A Canadian broker or agent should be independent of the foreign business organization and not devote all or almost all its efforts to representing the foreign business. A foreign entity is liable for Canadian income tax if it has an employee or broker in Canada that has, and habitually exercises in Canada, the authority to negotiate and conclude contracts in its name.

Certain tax treaties provide that a foreign entity can, without becoming liable for Canadian income tax, have a fixed place of business in Canada that is used solely for:

- Storing, displaying, or delivering goods or merchandise.
- Maintaining a stock of goods or merchandise for storing, displaying, delivering, or processing by another person.
- Purchasing goods or merchandise.
- Collecting information.
- Advertising, supplying information, scientific research, or similar activities that have a preparatory or auxiliary character.

Branch Tax

The income of a non-resident supplier carrying on business through a branch in Canada (that is, by itself having offices, employees, files, or other aspects of a permanent establishment in Canada) is typically subject to a branch tax. The branch tax rate is 25% of the after-tax profits of the branch operations not being reinvested in Canada. The branch tax roughly equals the withholding tax, which would be otherwise payable on dividends paid by a Canadian subsidiary to its foreign parent organization. An applicable tax treaty can reduce this rate.

Whether a supplier's Canadian activities or presence gives rise to a permanent establishment is a question of fact that depends on both:

- The nature of the obligations and activities the contract contemplates.
- The specific provisions of any applicable tax treaty.

Passive Income Withholding

The income a foreign supplier that appoints a local distributor to sell its products in Canada earns through sales originating from the distributor can, depending on the distributor's fee structure, be characterized as passive income in Canada and subject to a withholding tax. The Canadian payor of any withholding tax must withhold and remit the tax on the non-resident recipient's behalf. The withholding tax rate is 25%, which can be reduced by an applicable tax treaty.

Canadian Sales Tax

Canada has a broad and tiered value-added tax (VAT) system that varies across provinces. The federal government imposes the goods and services tax (GST), a VAT on all taxable supplies made in Canada. The GST is currently 5% for all of Canada.

The provinces of Ontario, New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island have combined their provincial sales tax (PST) with the GST to form a single harmonized sales tax (HST) that is applied to all taxable supplies made in those provinces. The PST rate is 8% for Ontario and 10% for New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island. The combined HST rate is 13% and 15% respectively. Effective March 31, 2025, the PST rate in Nova Scotia is reducing to 9% for a combined HST rate of 14%.

The province of Québec has harmonized the Québec sales tax (QST) and GST. However, unlike in other harmonized provinces, the QST is a separate tax enforced under provincial legislation. The current QST rate is 9.975%

The provinces of British Columbia, Saskatchewan, and Manitoba have a separately charged provincial retail sales tax in addition to the GST. The provincial retail sales tax is currently 7% in British Columbia and Manitoba and 6% in Saskatchewan. Although these three provinces have a similar retail sales tax regime, care should be taken as there are certain differences.

The GST, HST, and QST apply to every transaction at each stage of the distribution chain, including goods imported into Canada. Exports are generally exempt. Accordingly, generally all businesses, including non-resident businesses, with a permanent establishment in Canada or that are otherwise deemed to be carrying on business in Canada are required to register for, charge, collect, and remit the applicable GST, HST, and QST on the taxable supplies they make in Canada and on sales of tangible personal property in prescribed circumstances.

A non-resident of Canada that has sales of tangible personal property exceeding CAD30,000 in any 12-month period that is located in Canada at the time of the sale to Canadian purchasers that are not registered for the GST, HST, or QST, as applicable, must register for GST, HST, and QST. A non-resident can also be required to specifically register for QST in Québec if its sales of tangible personal property delivered in Québec to purchasers that are not registered for QST exceed CAD30,000 in any 12-month period.

The determination of whether a non-resident supplier is carrying on business in Canada is a question of fact and the applied test is not a bright line test. A thorough review of all facts is required.

Despite the broad application of these taxes, non-resident suppliers can be entitled to recover or flow through to their Canadian customers the GST, HST, and QST they pay on their inputs, including goods imported into Canada, through various input tax credit mechanisms.

Competition and Antitrust Laws

The Competition Act regulates competition at the federal level in Canada. The Competition Act sets out several reviewable practices, which is business conduct that is permitted but can be subject to prohibition or other injunctive remedies by the Competition Tribunal (Tribunal) based on the conduct's anti-competitive effects. These reviewable practices include:

- Refusal to deal (see Refusal to Deal).
- Price maintenance (see Price Maintenance).
- Tied selling (see Tied Selling).
- Market restrictions (see Market Restriction and Customer or Territorial Restrictions).
- Exclusive dealing (see Exclusive Dealing).
- Abuse of dominance (see Abuse of Dominance).
- Mergers (see Mergers).
- Certain collaboration agreements (see Collaboration Agreements).

The reviewable practices provisions of the Competition Act are those most typically applicable to distribution agreements and they generally require anti-competitive effects to qualify for a remedy. However, the criminal offences in the Competition Act address per se prohibitions and are reserved for hard-core agreements between competitors that are naked restraints on competition.

The Competition Bureau (Bureau) is Canada's competition law enforcement agency. The Bureau enforces reviewable practices in the Tribunal. If the Tribunal finds a reviewable practice has had, or is likely to have, an adverse effect on competition in the market, it can order the supplier to accept the distributor as a customer on usual trade terms.

Most reviewable practices (except for mergers) can be the subject of private enforcement if a private applicant obtains leave from the Tribunal to bring the application. Beginning June 20, 2025, private enforcement is available for deceptive marketing practices and anti-competitive agreements if the Tribunal gives leave.

For more information, see Practice Notes, Competition Issues for Distribution and Supply Agreements in Canada and Canadian Conspiracy (Cartel) Law.

Refusal to Deal

Generally, a supplier can choose with whom they do business. However, refusing to deal with certain distributors can be subject to injunctive relief if the refusal:

- Occurs even though the distributor:
  - is willing and able to meet the supplier's usual terms; and
  - has ample supply of the product.
- Prevents the distributor from being able to obtain adequate supplies of the product, which substantially harms its ability to do business.
- Is due to insufficient competition among suppliers.
- Has or is likely to have an adverse effect on competition.

(Section 75, Competition Act.) A refusal to deal can also be an abuse of dominance (see Abuse of Dominance).

Potential remedies for a refusal to deal include an order to accept a person as a customer or to make a means of repair available within a specified period on appropriate terms.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the refusal to deal will be available to private applicants who receive leave to bring a challenge.

For more information on refusals to deal, see Practice Note, Refusal to Deal (Competition Act, Section 75).

Price Maintenance

Price maintenance occurs when a supplier prevents a distributor from selling a product below a minimum price through a minimum resale price clause or otherwise. This conduct also occurs when a supplier refuses to supply to a distributor because of their low pricing policy.

Price maintenance violates the Competition Act when:

- A supplier threatens, promises, influences, or discourages the reduction of a distributor's charged or advertised prices.
- A supplier refuses to supply a product to a distributor because of the distributor's low pricing policy.
- A distributor, as a condition of doing business with a supplier, induces the supplier to refuse to supply to another distributor because of that distributor's low pricing policy.

(Section 76, Competition Act.)

Minimum advertised price programs, which restrict the minimum price a distributor can advertise a product (online or otherwise), can be a part of a supplier's co-operative advertising program. Including disclaimer language in resale price materials clarifying that distributors can sell the products for less and without being discriminated against for doing so can generally assist to mitigate risk.

Price maintenance can be subject to a remedy if the conduct has adversely affected competition in the market. These remedies include a prohibition order and an order to accept a person as a customer on usual trade terms.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the price maintenance will be available to private applicants who receive leave to bring a challenge.

For more information on price maintenance, see Practice Note, Resale Price Maintenance Under the Competition Act.

Tied Selling

Tied selling occurs when a supplier requires or induces a distributor to buy a second product as a condition of supplying another product. Tied selling also applies if the supplier conditions the supply of one product on the distributor not distributing another product from another brand or manufacture (Section 77, Competition Act).

Tied selling can be subject to a remedy if it is undertaken by a major supplier or is widespread in the market and substantially lessens competition. Potential remedies include a prohibition order and other necessary measures to overcome the effects of the conduct.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the tied selling will be available to private applicants who receive leave to bring a challenge.

Market Restriction and Customer or Territorial Restrictions

A market restriction occurs when a supplier requires a distributor to sell a product in a defined market or penalizes the distributor for selling the product outside of the specified market (section 77, Competition Act). This conduct can be subject to remedy if it is undertaken by a major supplier or is widespread in the market and substantially lessens competition.

Suppliers can restrict competition by restricting the territories in which its distributors can sell or the types of end customer to whom they can sell. If a dominant supplier engages in this activity, an abuse of dominance can apply if the conduct otherwise fits within the definition (see Abuse of Dominance). This conduct can also fall within the market restriction reviewable practice.

Potential remedies for market restrictions include a prohibition order and other necessary measures to overcome the effects of the conduct.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the market restriction will be available to private applicants who receive leave to bring a challenge.

Exclusive Dealing

Exclusive dealing occurs when a supplier requires a distributor to deal primarily or only with them or another designated supplier (section 77, Competition Act). Exclusivity can be mandated explicitly or induced through other methods, such as a most favoured nation (MFN) clause (see MFNs and Other Agreements Referencing Rivals).

Exclusive dealing conduct can be subject to a remedy if it is undertaken by a major supplier or is widespread in the market and substantially lessens competition. Potential remedies for exclusive dealing include a prohibition order and other measures necessary to overcome the effects of the conduct.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the exclusive dealing will be available to private applicants who receive leave to bring a challenge.

For more information on exclusive dealing, see Practice Note, Exclusive Dealing Under the Competition Act.

Abuse of Dominance

An abuse of dominance occurs when a dominant firm engages in activity that is intended to have a predatory, exclusionary, or disciplinary negative impact on the dominant firm's competitors or an adverse effect on competition. Examples of business practices that can be an abuse of dominance include:

- A vertically integrated supplier's margin squeeze of non-vertically integrated suppliers.

- A pre-emption of scarce facilities or resources that a competitor requires to operate its business.
- Predatory pricing.

(Section 78, Competition Act.)

To establish an abuse of dominance, a firm must be dominant in a market in Canada and either:

- The dominant firm engages in an anticompetitive act (see Competition and Antitrust Laws).
- The dominant firm's conduct results in a substantial lessening or prevention of competition in a market.

(Section 79, Competition Act.)

Depending on the conduct, the remedies for when a firm abuses its dominance can include:

- A prohibition order.
- A remedial order.
- A divestiture of asset or shares.
- A penalty of up to the higher of:
  - CAD25million for an initial instance and CAD35 million for subsequent instances; or
  - three times the value of the benefit derived from the anti-competitive practice or, if that amount cannot be reasonably determined, 3% of the company's annual worldwide gross revenues.

(Section 79, Competition Act.)

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from an abuse of dominance will be available.

For more information on abuses of dominance, see Practice Note, Abuse of Dominance (Sections 78 and 79 of the Competition Act).

Mergers

The Bureau can challenge a merger within three years of closing on the basis that it causes or is likely to cause a substantial lessening or prevention of competition in a market. The limitation period to challenge a merger is one year if the parties notified the Bureau regarding the transaction under the pre-merger notification provisions of the Competition Act. (Section 97, Competition Act.)

Under the Competition Act, a merger includes the direct or indirect acquisition or establishment by one or more persons of control over or a significant interest in the whole or part of a business of a competitor, supplier, customer, or other person. Control can be obtained by the purchase or lease of shares or assets, amalgamation, or a combination. (Section 91, Competition Act.)

While it is not typical for the Bureau to apply the merger provisions to a distribution arrangement, it can do so if it believes that the relationship of the parties fits within the definition. This would be a risk especially in circumstances where a party in a distribution arrangement obtains consideration in shares or assets.

For more information on merger control, see Practice Note, Corporate Transactions and Merger Control in Canada: Overview.

Collaboration Agreements

Hard-core cartel agreements between competitors regarding price-fixing, market allocation, supply restriction, and bid-rigging are per se illegal (that is, regardless of their impact on competition). The Competition Act also provides a civil remedy for non-cartel competitor collaborations. Under the civil competitor collaboration provisions, an agreement between competitors that results in a substantial lessening or prevention of competition in a market can be subject to a prohibition order, other injunctive relief, or conduct orders (such as divestiture and monetary penalties) by the Tribunal (see Abuse of Dominance).

Since December 15, 2024, this provision includes agreements that are not between competitors if it can be shown that a significant purpose of the agreement or part of the agreement is to harm competition and the agreement has the effect of preventing or lessening competition substantially. The Tribunal can make orders regarding past agreements or arrangements within three years of termination.

Effective June 20, 2025, disgorgement awards for up to the value of the benefit derived from the civil collaboration will be available to private applicants who receive leave to bring a challenge.

MFNs and Other Agreements Referencing Rivals

MFN clauses are arrangements between distributors and suppliers in which one party guarantees that the other receives the best price or terms for a product or service. For example, if a supplier offers a competing distributor a better price, the distributor with the MFN clause in its favour is also provided that better price.

This practice, along with other arrangements that reference rivals, can be an abuse of dominance and subject to prohibition remedies if the conduct results in a substantial lessening or prevention of competition or is intended to. This can occur, for example, if the conduct results in the maintenance of materially higher prices than would otherwise occur but for the MFN.

For more information on MFN clauses, see Practice Note, Exclusive Dealing, Meet-or-Release and Most-Favoured-Nation Clauses and the Competition Act.

Dual-Distribution

Dual-distribution arises when a supplier that sells a product to a distributor for re-sale also sells the same product and competes with the distributor in the same market. The Bureau does not generally consider dual-distribution agreements to be per se prohibited and are generally reviewed under the reviewable practices provisions if they result in anti-competitive effects (see Competition and Antitrust Laws). However, the criminal provisions of the Competition Act can apply if those agreements either:

- Fix prices, allocate markets, or restrict output regarding products that are not supplied as part of the dual-distribution arrangement.
- Are a sham to implement price fixing, market allocation, or output restriction.

For more information, see Resale Price Maintenance Checklist: Dual Distribution-Related Issues.

Minimum Purchase Obligations

Suppliers can set minimum purchase obligations that require a distributor to purchase a designated quantity of goods over a specified period. If a dominant supplier engages in this activity in a predatory, exclusionary, or disciplinary way, it can be considered an abuse of dominance (see Abuse of Dominance).

Covenants not to Compete

Covenants not to compete can be unenforceable at common law. The test for enforceability is based on reasonableness, which is measured by:

- The geographical area.
- The time period.
- The scope of activities the restriction covers.

The narrower the restrictions within a non-compete provision, the higher the potential enforceability.

The Bureau can assess covenants not to compete under the reviewable practices provisions of the *Competition Act* and would generally only be considered per se unlawful if they are a hard-core cartel, which includes no-poach and wage-fixing agreements between employers. A non-compete or no-poach or wage-fixing clause in a broader and lawful distribution arrangement would likely be considered by the Bureau under the civil competitor collaboration provision, although the Bureau could apply the criminal cartel provisions if it is of the view that less restrictive means were reasonably available to the parties at the time when the agreement was entered into.

Product Regulatory Requirements and Product Liability Laws

Product Regulation and Safety

In Canada, a supplier and distributor can be jointly or severally responsible for ensuring products imported and sold into Canada comply with applicable legal and regulatory requirements.

The primary statute governing the regulation and safety of consumer products in Canada is the CCPSA. The CCPSA protects the public by addressing and preventing the dangers that consumer products pose to human health and safety, including domestically manufactured and imported products.

The CCPSA prohibits the manufacture, import, advertisement, and consumer sale of a product that is:

- A danger to human health or safety.
- The subject of a Minister of Health (Minister) recall order or a voluntary recall because the product is a danger to human health or safety.
- The subject of a required Minister order measure that the manufacturer or importer has not carried out.

The CCPSA also prohibits the packaging or labelling of a consumer product in a manner that:

- Is false, misleading, or deceptive.
- Can reasonably be expected to create an erroneous impression regarding:
  - it not being a danger to human health or safety; or
  - its certification as a safe and compliant product within the meaning of the CCPSA.

A consumer product is deemed to be a danger to human health or safety if it:

- Poses an unreasonable hazard, existing or potential, during, or resulting from its normal or foreseeable use.
- Can reasonably be expected to cause the death of an individual exposed to it or have an adverse effect on that individual's health, whether or not the death or adverse effect occurs immediately after the exposure to the hazard, including any exposure that can reasonably be expected to have a chronic adverse effect on human health.

Specific risks relating to classes of consumer products, such as drugs and medical devices, food, and motor vehicles are excluded from the CCPSA and are instead directly regulated under other specific statutes, such as:

- Food and Drugs Act, R.S.C. 1985, c. F-27 regarding drugs and medical devices.
- Canadian Food Inspection Agency Act, S.C. 1997, c. 6, regarding regulated foods.
- Motor Vehicle Safety Act, S.C. 1993, c. 16 regarding motor vehicles.

CCPSA Schedule 1 includes the full list of excluded consumer products.

In addition to regulating the types of products that enter Canada, the CCPSA imposes obligations on manufacturers, suppliers, importers, distributors, and retailers dealing in consumer products. The CCPSA requires any person who manufactures, imports, advertises, sells, or tests a consumer product for commercial purposes to prepare and maintain documents that indicate, among other things:

- The name and address of the person that they obtained the product from, sold the product to, or both, as applicable.
- The location where and the period during which they sold the product.

These documents must be:

- Retained for six years from after the end of the year to which they relate.
- Stored at the person's place of business in Canada and provided to the Minister on request.

If an incident involving a consumer product arises, the CCPSA requires the person who manufactures, imports, distributes, or sells the consumer product in Canada to provide the Minister with all the information in their control regarding the incident within two days. Thereafter, the product's domestic manufacturer or the importer or distributor of a foreign-made product must provide the Minister with a written report containing all information about the incident, product involved, and remedial measures they propose to take within ten days after they became aware of the incident.

An incident under the CCPSA is:

- An occurrence in Canada or elsewhere that caused or can cause death or serious adverse health effect.
- A situation where:
  - a dangerous product defect is identified;
  - an incorrect, insufficient, or non-existent label creates a risk of death or serious adverse health effect; or
  - another domestic or foreign public body initiates a recall of the product.

After the incident report is delivered to the Minister:

- A manufacturer or distributor can voluntarily issue a product recall.
- The Minister can take any measure deemed necessary to remedy non-compliance, including:
  - issuing a product recall;
  - ordering the seizure, removal, or forfeiture of non-compliant products; and
  - ordering product safety tests to ensure CCPSA compliance.

Despite the Minister's power to remedy any non-compliance and assign responsibility to either or both the supplier and distributor, parties to a distribution agreement can negotiate the allocation of responsibilities between themselves and should include comprehensive limitation of liability and indemnity provisions in their agreements that clearly articulate:

- Each party's responsibility for ensuring the product complies with applicable requirements for distribution in Canada.
- Which party assumes responsibility for responding to an incident.
- Each party's liability if an incident occurs.

Consumer Product Liability Claims

Except in the Province of Québec, a manufacturer or distributor of a defective product can be jointly or severally liable to a consumer or other party injured by the product based on contract or tort law principles. The basis for holding a manufacturer or distributor liable in contract is a breach of warranty or other term in the contract regarding the quality or attributes of the product. These terms are often expressly agreed to in warranties or representations in the contract or conduct of the parties.

Most provinces in Canada also have sale of goods legislation that imposes certain implied warranties on consumer products that a distributor (and, in Québec, a manufacturer) cannot disclaim. These warranties, include:

- A durable use warranty.
- A reasonable lifetime warranty.
- A warranty of merchantable quality for a reasonable period.
- A warranty against hidden defects.

Except in Québec, these warranties are implied in the contract of sale between the product distributor and consumer. Accordingly, recourse is principally against the distributor as opposed to the manufacturer, if different.

A common way for a distributor to mitigate its responsibility for and satisfy these implied warranties is to obtain a manufacturer's warranty for its customers from the manufacturer. Although there may be no privity of contract between the manufacturer and the distributor's customers or end consumer, the common law treats a manufacturer's warranty as a representation inducing the sale. This allows the customer to directly sue the manufacturer and affords the distributor an additional defense and opportunity to seek contribution and indemnity from the manufacturer for any damages it is ordered to pay the customer.

A consumer can rely on the tort of negligence to advance a product liability claim. A tort claim is founded on the theory that parties who design, manufacture, or sell products owe a duty to exercise reasonable care to ensure the products do not create an unreasonable risk of injury to users and others. Under tort law, product liability can be found due to:

- A design defect.
- A manufacturing defect.
- A failure to warn of potential dangers arising from the product's use.

Canadian courts have held that a duty of care can be owed by almost any participant in the supply chain, including manufacturers, suppliers, distributors, and retailers.

In Québec, the CCQ contains product liability laws. Specifically, CCQ articles 1726 to 1731 address contractual claims and articles 1468, 1469, and 1473 address extra-contractual claims. The CCQ provisions on this issue are reinforced by the consumer sales provisions, specifically, sections 34 to 54 of Québec Consumer Protection Act, CQLR, c. P-40.1 (QC CPA).

Québec law imposes statutory warranties of quality and adverse legal presumptions for an alleged product defect. These statutory warranties the CCQ and QC CPA provide are available to a purchaser and subsequent purchasers of goods directly against any person involved in the chain of distribution of a good, including the manufacturer, merchant, and seller and any distributor, dealer, importer, or wholesaler of the good in the supply chain.

A party to a contract cannot exclude, limit, or waive the benefit of the statutory warranties provided under the CCQ and the QC CPA. Sellers (including manufacturers and distributors) are presumed to know about any defects affecting their goods. Consequently, no exclusions or limitations of liability or quality waivers in a contract protects a seller unless the seller can rebut this presumption with evidence confirming that both:

- It did not know about the defect.
- Its lack of knowledge was justified in that it could not have discovered the defect even if it had taken every reasonable precaution.

Appointing a Distributor and Structuring the Distribution Relationship

There are numerous commercial arrangements available to parties looking to establish a distribution relationship. Common distribution arrangements include:

- A joint venture, where a supplier partners with a local distributor that the supplier partly owns to distribute its goods and services.

- A distributor (also referred to as a wholesaler or dealer), where a supplier contracts with independent businesses that purchase inventory from the supplier for re-sale to other retailers and end users.
- A white or private label, where a supplier contracts with a distributor to sell its products or services under the distributor's trademarks or another independent white or private label. This arrangement allows the foreign supplier to penetrate the market and sell its products in Canada under a recognized brand but affords the supplier no brand recognition and often little or no control over the marketing, presentation, and sale of the product.

Each of these arrangements can be structured as an exclusive, non-exclusive, sole, or selective agreement. The parties can determine their respective rights and obligations under the agreement if they comply with applicable laws.

Relationship of the Parties

Employment Law Considerations

A supplier negotiating a distribution agreement wants to avoid the risk of a distributor or its employees being treated as the supplier's employees or as dependent contractors.

An independent contractor is a self-employed worker who serves clients through their own business. This status is distinct from that of an employee, who provides services to an employer as part of the employer's business.

Employment law treats independent contractors and employees differently. Employees enjoy greater legal protections in the workplace and employers have greater legal duties towards employees. Independent contractors and their clients are left relatively free to negotiate the terms of a working relationship as they see fit. Dependent contactors, which are a subset of independent contractors, have certain rights that are similar to those of employees.

In connection with the distinction between an employee and independent contractor, the core question is whether a worker is in business for their own account. The adjudicator applies a two-step inquiry to determine whether the worker is performing services on their own account or is engaged as an employee (*1392644 Ontario Inc. v. Minister of National Revenue, 2013 CarswellNat 663 (Fed. C.A.)*).

First, the adjudicator considers each party's subjective intent, which can be determined by the contract's terms or each party's behaviour. Second, the adjudicator examines whether an objective reality sustains the subjective intent of the parties by considering:

- The level of control the employer has over the worker's activities.
- Whether the worker provides their own equipment.
- Whether the worker hires their own helpers.
- The degree of financial risk the worker takes.
- The degree of responsibility for investment and management the worker has.
- The worker's opportunity for profit and the performance of their tasks.

(671122 Ontario Ltd. v. Sagaz Industries Canada Inc., *2001 CarswellOnt 2257 (S.C.C.)*.)

A dependent contractor is an intermediate position between an employee and independent contractor. The same legal principles used in differentiating between independent contractors and employees applies to dependent contractors. After a worker is found to be a contractor, the court determines whether the worker is independent or dependent based on the exclusivity and dependence of the worker in the relationship (McKee v. Reid's Heritage Homes Ltd., *2009 CarswellOnt 8053 (Ont. C.A.)*.

Generally, distributors are considered independent contractors. However, a supplier that exercises sufficient control over a distributor's means and methods for performing its duties risks the distributor being deemed the supplier's employee or dependent contractor and potentially triggering an unintended franchise classification (see Franchise Law Considerations).

The employees or employment liabilities of the supplier or distributor generally do not transfer to the other when the distributor is appointed or terminated except in limited circumstances, such as if:

- An outgoing distributor sells all or substantially all its assets to the supplier (or vice versa) and the court recognizes corporate successor liability on the facts.

- The supplier exercises sufficient control over the employment terms of the distributor's employees so that the parties are considered common employers under the employment standards law, which is unusual in a typical distribution relationship.

Franchise Law Considerations

Canada regulates franchising at the provincial level. Six provinces (Regulated Provinces) have enacted franchise-specific legislation that is currently in force (Franchise Statutes):

- Alberta, under Franchises Act, R.S.A. 2000, c F-23.
- British Columbia, under Franchises Act, S.B.C. 2015, c. 35.
- Manitoba, under The Franchises Act, C.C.S.M. c. F156.
- New Brunswick, under Franchises Act, R.S.N.B. 2014, c. 111.
- Ontario, under Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c. 3.
- Prince Edward Island, under Franchises Act, R.S.P.E.I. 1988, c. F-14.1.

In 2023, Saskatchewan became the seventh Canadian province to enact franchise legislation when it introduced the *Franchise Disclosure Act* (Saskatchewan Act). The Saskatchewan Act received royal assent on May 8, 2024 but has not yet come into force due to the pending and unpublished regulations that are required to interpret and apply the statute. The Saskatchewan Act and its regulations are expected to be substantially the same as the Franchise Statutes in the existing Regulated Provinces.

While there are subtle differences between the Franchise Statutes of the Regulated Provinces, the definition of a franchise is generally consistent and includes satisfying all of the following key elements:

- A right to engage in a business where the franchisee must make a payment or continuing payments to the franchisor or its associate while operating the business or as a condition of acquiring the franchise or commencing operations.
- A right to sell or distribute goods or services that are substantially associated with a trademark, trade name, logo, advertising, or other commercial symbol that is owned by or licensed to the franchisor or its associate.
- The exercise or right to exercise significant control over or significant assistance in the franchisee's method of operation.

Alternatively, a franchise can exist if both:

- The grant of representational or distribution rights, regardless of whether a trademark, trade name, logo, advertising, or other commercial symbol is involved, to sell or distribute goods or services the franchisor or its designee supplies.
- The franchisor, or its associate or designee, provides location assistance, including securing retail outlets, sales displays, or accounts for the goods or services to be sold or distributed.

The definition of a franchise is broad and often captures other business formats that are not traditionally considered or intended to operate as a franchise, such as distributorships or simple licence arrangements. Parties to a distribution agreement often include provisions to convey their intent to form a distribution agreement that is not a franchise. However, the Franchise Statutes expressly preclude waiving or contracting out of the governing Franchise Statute and the inclusion of these provisions does not prevent a court from classifying the relationship as a franchise when the definition is met (Fyfe v. Vardy (Dial A Bottle), *2018 CarswellOnt 14132 (Ont. S.C.J.)* at paragraph 15).

If a distribution arrangement is classified as a franchise, the franchisor supplier must deliver a franchise disclosure document (FDD) to the franchisee distributor at least 14 days before any agreement is signed or consideration is accepted. The form and contents of a FDD are prescribed in the Franchise Statutes. A supplier's failure to deliver an FDD or delivery of a non-compliant FDD allows the distributor to rescind the franchise agreement within up to two years, depending on the circumstances. The Franchise Statutes also impose a duty of fair dealing on the parties, which includes a duty to act in good faith and in accordance with reasonable commercial standards.

Import Requirements

The importation of goods into Canada, are mainly governed by:

- Customs Act, R.S.C. 1985, c. 1 (2nd Supp).
- Customs Tariff, S.C. 1997, c. 36.
- Special Import Measures Act, R.S.C. 1985, c. S-15.

Export and Import Permits Act, R.S.C. 1985, c. E-19, also controls the import of certain articles. Collectively, these statutes, together with the applicable federal and provincial taxation, consumer protection, product safety and labelling, and language statutes referenced in this Note, govern the import and distribution of goods and services in Canada.

Foreign suppliers can serve as importers through the non-resident importer program. Distributors based in Canada can also serve as importers.

Canada implemented the Administrative Monetary Penalty System (AMPS), which is a civil penalty regime designed to secure compliance with Canada's import and export obligations by imposing escalating monetary penalties each time an importer or exporter commits an infraction. Penalty and duty relief remissions, drawbacks, and exemptions can be available in certain cases. Remissions provide relief from customs duties for eligible goods, while drawbacks provide a refund of customs duties or taxes paid on imported goods that were subsequently exported or for goods used for specific purposes.

While both parties must comply with applicable laws regulating their respective role and activities in the relationship, except for antidumping and countervailing duties, parties can negotiate and allocate between themselves varying responsibility or indemnities for paying custom duties. For example, a distribution agreement can require a foreign supplier to reimburse a Canadian distributor for duties it paid as importer of record.

Current international trade tensions and unprecedented tariff and retaliatory tariff threats among key trade partners may materially alter existing legislation and historical practices and policies around the import, export, and movement of goods and services across borders. Close attention should be paid to this rapidly evolving landscape.

Intellectual Property Issues

The Trademarks Act, R.S.C., 1985, c.T-13, protects trademarks. A trademark can be valid and used in Canada without being registered. Similarly, a distributor can import and sell a foreign supplier's goods and services in Canada without being registered as the owner or user of the foreign supplier's trademark.

A distributor does not acquire any rights, implied or otherwise, in a supplier's trademarks or IP by importing or distributing the supplier's branded products or services. All trademarks, IP ownership, and associated rights remain with the owner of the trademarks and other IP. Typically, the distribution agreement addresses any rights conferred on the distributor to license, use, or sublicense to others the right to use the supplier's trademarks or IP.

In certain circumstances, where there is a dispute on whether a distributor owned or licensed the trademarks, a trademark licence can be inferred or implied (even absent a written or oral agreement) if there is clear evidence that the trademark owner retained control over the character and quality of the goods and services (*Corey Bessner Consulting Inc. v. Core Consultants Realty Inc.*, 2020 CarswellNat 322 (F.C.), paragraph 70).

While not mandatory, the registration of trademarks with the Canadian Intellectual Property Office makes enforcement significantly easier. A registration, unless proven invalid, provides the registered owner an exclusive right to use the trademark across all of Canada and prevent third parties from using confusingly similar trademarks. To enforce unregistered trademark rights, the trademark owner must establish a reputation in the territory where it wishes to enforce the trademark and bring a passing off action against the offender.

A supplier can be restricted in directly enforcing its trademark rights in Canada, including registered marks, regarding grey market goods, also known as parallel imports. Parallel imports is the practice of diverting goods that were originally intended for sale in one market to other markets without the trademark owner's permission.

Under Canadian law, selling grey market goods is not typically trademark infringement or passing off. The principle purpose of trademark law is to protect a consumer from confusion regarding a product's source. Grey market goods are not counterfeit, as they originate from the legitimate trademark owner. Therefore, there is no confusion as to the product's source and, by consequence, no infringement or passing off. In addition, under the doctrine of exhaustion, the first permitted sale of an item exhausts the trademark owner's ability to control subsequent sales of that item once it is placed into commerce.

Despite the above restrictions, Canadian courts have applied the *Trademarks Act* where a Canadian company is the registered owner of the trademarks to block parallel imports and unauthorized sales of grey market goods that did not originate in Canada. The Canadian company must be distinct from the foreign supplier. This protection has been extended to Canadian affiliates and wholly owned subsidiaries of multinational corporations.

A supplier that is concerned about parallel imports should ensure that the local distributor owns the trademarks in Canada. To maintain the supplier's interests in the marks when the distributor is not the supplier's affiliate or wholly owned subsidiary, the distribution agreement should provide that any assignment or transfer of the marks to the distributor revert back to the supplier on the expiration or termination of the parties' relationship for any reason.

A patent or industrial design registration is required to enforce rights to an invention or design.

Copyright protection is automatic for qualifying creative works but registration is recommended, as it creates a rebuttable legal presumption that copyright subsists in the work and belongs to the registered owner. Copyright holders also have a level of protection against parallel imports under the *Copyright Act. R.S.C., 1985, c.C-42.*

The remedies available to a supplier to protect and enforce its IP varies depending on the IP in question but can range from injunctive relief to claims for infringement and passing off. A supplier can exercise these remedies against both its distribution partners and third parties.

A distribution agreement should always explicitly address IP rights so that the precise scope of any rights granted to the distributor and any obligations related to IP are clear. Care should be taken to ensure that the parties are not inadvertently entering into a franchise relationship, which attracts other rights and obligations for the parties (see Franchise Law Considerations).

Online Sales Considerations

Online sales of goods and services are subject to many of the same commercial and consumer protection laws that exist for the traditional forms and methods of purchase and sale.

In Canada, e-commerce legislation is generally considered a matter of provincial jurisdiction. Any federal legislation dealing with electronic documents and related electronic filings generally apply to matters dealing with the federal government or federally regulated industries.

To resolve the legal uncertainties that surround many aspects of e-commerce, most Canadian provinces have modeled their legislation on the Uniform Electronic Commerce Act, 2000, 6-1 (UECA). Despite the commonalities among the various provincial e-commerce statutes, certain material differences make it necessary to refer to the statute of the province where business occurs for the specific applicable requirements in that province. In Québec in particular, the Act to Establish a Legal Framework for Information Technology, CQRL c.C-1.1 includes many differences from the UECA.

Provincial e-commerce legislation allows contracts to be formed with electronic information or electronic documents and actions (for example, clicking or touching a computer icon) to communicate intention (that is, offer and acceptance).

Electronic agents can form contracts with individuals. However, these transactions are unenforceable against the individual if:

- The individual makes a material error in the electronic document or information used in the transaction.
- The electronic agent does not give the individual an opportunity to prevent or correct that error.
- The individual promptly notifies the other person on learning of the error.
- Where consideration is received because of the error, the individual takes reasonable steps to return or destroy the consideration (if so instructed) and the individual has not used or received any material benefit or value from the consideration.

Although there is no legal requirement for an electronic contract to be in writing or signed, to enforce the contract against the other party, the traditional legal requirements for enforceable contracts (that is, offer, acceptance, and consideration) must be satisfied. The parties should ensure that the terms are clear and unambiguous (and unaltered) and that the signatures are reliable to identify the parties and indicate a clear intention to be bound.

Other federal and provincial laws, such as those relating to privacy, advertising, language, and consumer protection, also apply to online businesses and online contracts. For example, in Ontario, certain provisions of Ontario Consumer Protection Act, S.O. 2002, c.30, Schedule A, apply to internet agreements with consumers and impose stringent disclosure obligations on vendors and various cancelation rights for consumers. Vendors must also disclose certain information to consumers and provide the contract in a manner that enables it to be printed. If vendors do not disclose the required information, the consumer can cancel the agreement on notice to the vendor.

Competition law also applies to online distribution and sales. In Canada, the civil reviewable provisions of the *Competition Act*, which include an abuse of dominance (monopolization), generally apply to vertical distribution arrangements. The *Competition Act*'s criminal provisions apply to horizontal hard-core cartel conduct between competitors. All these provisions can be relevant to online distribution relationships depending on the circumstances (see Competition and Antitrust Laws).

Confidentiality and Protection of Personal Data

Confidentiality

Under Canadian law, parties to a distribution agreement can impose restrictions on the use or disclosure of their respective confidential information during and after the termination of the agreement.

The definition of confidential information can be party neutral and relatively broad in scope or narrow and specific if a party wishes to limit the scope of information deemed confidential or has a particular interest in protecting specific information from becoming public. The distribution agreement, including any ancillary agreements, product, pricing, purchasing, and development schedules, is often included within the definition of confidential information.

Protection of Personal Data

The parties' ability to exchange information on end users depends on whether they have complied with applicable federal and provincial privacy legislation.

Personal data is protected at both the federal and provincial level in Canada. The governing federal statute is Personal Information Protection and Electronic Documents Act, S.C. 2000, c.5 (PIPEDA). Except in Alberta, British Columbia and Québec, which are the provinces that adopted their own privacy laws for the private sector, PIPEDA applies to all federally regulated private-sector organizations and provincially regulated private sector organizations across Canada that collect, use, or disclose personal information during commercial activity . Private sector organizations in the health sector can be governed by provincial and territorial personal health information protection laws.

PIPEDA can also apply to businesses established or resident outside of Canada. The Office of the Privacy Commissioner of Canada can investigate foreign entities, including those whose collection activities occur outside of Canada, if there is a real and substantial connection between those activities and Canada (Lawson v. Accusearch Inc.*, 2007 CarswellNat 247 (F.C.)*).

Generally, businesses subject to provincial privacy laws are exempt from PIPEDA regarding the collection, use, or disclosure of personal information that occurs within that province. However, a business can be subject to both federal and provincial privacy laws. For example, certain activities, such as collecting personal information within a province, can be subject to a provincial privacy law, whereas other activities, such as the disclosure of personal information across provincial or national borders, is subject to PIPEDA regardless of the province or territory in which it is based.

Businesses governed by PIPEDA or the applicable provincial statute, must:

- Obtain an individual's informed consent before any collection, use, or disclosure of that individual's personal information.
- Allows individuals to access any personal information held by the business and challenge or correct its accuracy.
- Disclose to individuals in advance all intended or potential uses of their personal data.
- Use the information collected for only the express and limited purposes for which the individual granted their consent.

All personal information a business collects must be protected using appropriate safeguards. If a business intends to use third parties to process or store personal data or otherwise transfer or house it offsite domestically or abroad, the individual to whom the personal data pertains must be notified that their:

- Personal information will be transferred, stored, or otherwise processed offsite or outside Canada.
- Data may be subject to the laws of that jurisdiction.

Businesses undertaking these transfers must use contractual or similar means to ensure that data exposed to outsourcing or transfer arrangements is protected with the same or comparable safeguards applicable to and employed by the business in its native jurisdiction. In this regard, Québec law requires organizations to perform a privacy impact assessment before transferring personal data outside Québec to ensure the destination jurisdiction provides adequate protection under generally recognized principles regarding the protection of personal information.

All private sector privacy laws in Canada except the British Columbia *Personal Information Protection Act* require a business to report a data security breach to the regulator and notify individuals where the breach creates a real risk of significant harm. The business must maintain records of all security breaches, whether reportable or not, involving personal information under its control.

Parties to a distribution agreement that comply with all applicable privacy laws can determine how personal data is protected, shared, and used in the relationship. A business transferring personal data through a distribution agreement must use contractual or other means to ensure it receives a comparable level of protection.

As of September 22, 2024, organizations (which would include parties to a distribution agreement) that process personal information from Québec must be aware of and comply with the right to portability. Under Québec law, organizations must communicate, on request, computerized personal information collected from the applicant that is not created or inferred in a structure and commonly used technological format to any person or body as requested by the applicant.

Payment Terms

Parties to a distribution agreement can negotiate applicable payment terms, which are often informed by the nature of the transaction. The key payment terms that should be in a distribution agreement include:

- The pricing or fee rates.
- The due date.
- The currency and payment method.
- Any interest due on overdue or late payments. The interest rate should be stated as an annual interest rate and cannot exceed 35% annual percentage rate.
- The penalties for non-payment.

Foreign suppliers can require Canadian distributors to pay for goods by letter of credit to ensure the supplier receives payment. Depending on a distributor's creditworthiness, a foreign supplier can sell to a distributor on credit terms, in which case the supplier typically seeks to secure the payment obligation using other methods, including:

- Taking a security interest or purchase-money security interest in the goods sold to the distributor.
- Obtaining a guarantee, bond, or a standby letter of credit.
- Using export credit insurance.

If taking a security interest or purchase-money security interest, the supplier needs to perfect (that is, register in the applicable provincial registry) its security interest to avoid losing priority to another creditor of the distributor. Secured transactions are generally governed at the provincial level under the Personal Property and Security Act in the common law provinces and territories and the CCQ in Québec.

Registrations of tangible property are governed by lex situs (the law of the jurisdiction where the charged property is situated at the time the security interest attaches). If the property is in more than one jurisdiction, multiple filings in multiple provinces can be required. The debtor's chief executive office governs the validity and perfection of a security interest over intangible property and mobile goods.

Exceptions exist where the property charged as collateral is regulated by federal law, such as IP. In these circumstances, the relevant federal law and registries govern. For example, registration of a security interest in a trademark must be registered with the Canadian Intellectual Property Office.

A supplier can add a no set-off clause in a distribution agreement to specify that the supplier must be paid for the goods or services regardless of other claims the distributor may have against the supplier.

Limitation of Liability

The parties can negotiate and include limitation and exclusion of liability provisions in their agreements. Common limitation of liability provisions include:

- Excluding certain causes of action or types of damages, for example consequential, indirect, and punitive damages.
- Setting a cap on the maximum damages a party can recover.
- Setting a limitation period for bringing a claim.

Generally, limitations of liability in commercial transactions are enforceable under Canadian law if the facts are supportive and there is no unconscionability or a public policy reason to not enforce the provision (Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways), *2010 CarswellBC 296 (S.C.C.)*, paragraphs 122-123).

Limitation of liability clauses in contracts by mutual agreement have been given full effect based on the principle of freedom of contract (*6362222 Canada inc. v. Prelco inc*., 2021 CarswellQue 16144 (S.C.C.). Notably, limitation of liability clauses in Québec are subject to the CCQ, which prohibits a party from attempting to contractually exclude or limit its liability in certain circumstances such as:

- The liability of a manufacturer, distributor, and professional seller (section 1733, *CCQ*).
- Sales contracts (sections 1732-1733, *CCQ*).
- Consumer contracts (section 10, *QC CPA*).
- Gross or intentional fault (section 1474, *CCQ*).
- Moral or bodily injury (section 1474, *CCQ*).

The various codes of ethics of professional orders in Québec can similarly impose certain limitations.

Indemnification and Insurance

Indemnification

The parties can negotiate the inclusion, exclusion, terms, and scope of indemnification provisions. Most distribution agreements include comprehensive indemnification provisions in which one or both parties agree to indemnify the other against certain events or claims, subject to a common carve out for losses directly or indirectly caused or contributed to, in whole or in part, by the indemnified party's own actions, omissions, or negligence.

Common areas of indemnification include direct or third-party claims relating to:

- Breaches of any representations, warranties, or covenants.
- Breaches of any product liability, performance, or service warranties.
- The operation of the indemnifying party's business, including employment claims.
- Breaches of applicable laws.
- IP and trademark infringement, which is often a separate indemnity provision.

Where one party agrees to indemnify the other for certain claims, particularly IP or product liability claims, the indemnifying party often requires the indemnified party to cooperate in the defense of any these claims as requested and reserves the right to control the proceeding.

Indemnification clauses are generally enforceable by giving effect to the plain and ordinary meaning of the provision unless doing so would be unreasonable or unconscionable.

Insurance

Distribution agreements often require parties to maintain certain insurance coverage. Particularly for contracts involving consumer goods, distributors can require suppliers to take out a comprehensive general liability insurance policy, including product liability coverage, to ensure there are funds available to pay or settle any claims. Similarly, distributors must often maintain general liability insurance to protect the supplier against claims arising from the distributor's operations and management of the business.

Term of the Agreement

The term of a distribution agreement depends on the parties' relationship and nature of the transaction. Distribution agreements are typically either:

- Fixed term agreements, which end automatically on agreed an date, subject to the parties' right to terminate for cause (or convenience if permitted by the agreement). Fixed term agreements can include renewal options that can be exercised:

  - on notice and the satisfaction of certain conditions; or
  - automatically when the initial term expires unless either party gives notice of its intention to not renew.

- Open-ended agreements, which can be terminated at any time for convenience without cause on reasonable notice. The parties can determine the required notice period themselves, failing which common law reasonable notice applies (see Terminating the Distribution Agreement).

Marketing and Promotion

Parties to a distribution agreement can determine how their goods are marketed and advertised and what each party's role and liability is in connection with those marketing strategies. Advertising is directly and indirectly regulated at both the federal and provincial level in Canada. The federal government directly regulates advertising through the *Competition Act*, under Part VII.1, which prohibits false or misleading advertising.

Advertising Standards Canada administers the Canadian Code of Advertising Standards, which prescribes the requirements for acceptable advertising and guidance on:

- What is inaccurate, deceptive, or otherwise misleading claims, statements, or representations.
- Price claims, comparative advertising, and testimonials.

Several provinces indirectly regulate advertising though various provincial consumer protection and business statutes, which include provisions prohibiting false, misleading, or deceptive representations and unfair or bad faith business practices. Several of these statutes include specific restrictions against representing that products offer any particular benefit or standard of quality, inaccurate or misleading pricing, and other unconscionable representations.

Most distribution agreements expressly detail the scope, nature, and limitations on a distributor's right to market and advertise the subject goods and services. These rights are often subject to the supplier's prior review and approval and current advertising standards and policies.

Compliance with Laws and Supplier's Policies

Distribution agreements in Canada typically include a general compliance with laws clause, requiring parties to comply with all applicable laws and regulations.

Canada recently adopted its first reporting legislation for modern slavery and child labour, Fighting Against Forced Labour in Supply Chain Act, S.C. 2003, c.9, which is part of an increasing response from Canada on business and human rights considerations and human rights in supply chains. The act requires reporting forced labour and child labour in supply chains for a broad range of reporting entities, as defined under the act. Public Safety Canada has released guidance on the reporting requirements and prescribed format of the required report (see Public Safety Canada, Public Safety Canada, Guidance for Entities).

In keeping with these compliance developments, distribution agreements also increasingly include clauses that specifically address one or both parties' obligations to comply with supply chain and sustainability laws, including slavery, human trafficking, anti-corruption, and anti-bribery laws. Frequently, suppliers include provisions requiring distributors to comply with the supplier's sustainability policies around issues, such as ethical business, employment, environmentally conscious practices, anti-bribery and prevention of terrorist financing policies, supply chain reporting, international trade sanctions, and codes of conduct.

Choice of Law and Forum

The parties can choose the governing law and forum that governs their relationship in the distribution agreement.

While all Canadian provinces have sale of goods legislation, except for Québec, where the CCQ applies to the commercial sale of movables, all provinces permit the selection of a foreign governing law and forum if the selected law does not breach any mandatory local laws or domestic public policy. Mandatory domestic laws that cannot be overridden by contract include competition, privacy, and criminal law matters.

In Québec, CCQ Article 3011 governs choice of law and regulates private relationships in the province.

This choice of law clause does not automatically divest Québec courts of jurisdiction, as the court can apply foreign laws if properly introduced into evidence (Article 2809, *CCQ*). A such, a contract make an explicit distinction between the choice of forum and choice of law.

If Canadian law is selected or otherwise applicable to a sale of goods agreement and the supplier's country is also a party to the CISG, the CISG automatically applies and preempts applying any domestic sale of goods laws unless the parties specifically exclude, limit, or vary the CISG's application. Canadian courts have not published case law on whether they would apply the CISG to a distribution agreement as a whole or only to individual sales. It is expected that the CISG would not govern a distribution agreement if the agreement's provisions focus on the organization of the distribution rather than the specific terms of the sales contracts to be concluded on the ordering of goods.

Canadian courts generally enforce the parties' choice of law and forum selection clauses. Therefore, the parties can select foreign law and non-Canadian forums to resolve their disputes, even where the issues in dispute arise in Canada.

The parties can select arbitration and other alternative dispute resolution (ADR) forms to resolve disputes under their agreement to the exclusion of Canadian courts. ADR procedures are recognized and accepted mechanisms for dispute resolution across Canada. However, certain judicial remedies, such as injunctive relief and other extraordinary remedies, remain available despite an ADR provision.

Judgments issued from foreign courts are generally enforceable in Canada through either the common law process the Supreme Court of Canada articulated in *Morguard Investments Ltd. v. De Savoye*, *1990 CarswellBC 283 (S.C.C.)*, or other reciprocal enforcement legislation if the judgment in question is issued by a jurisdiction governed by reciprocal enforcement legislation. In Québec, the CCQ governs enforcement of all non-Québec judgments.

Certain foreign arbitration awards are similarly recognized and enforced in Canada, as Canada is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Terminating the Distribution Agreement

Legal and Contractual Obligations on Termination

Distribution agreements can be terminated for cause or without cause for convenience by providing notice as required in the agreement or, if the agreement is silent, reasonable notice. Reasonable notice varies depending on the facts of each case. The factors considered in determining reasonable notice include:

- The length and nature of the parties' relationship, including whether it was exclusive.
- The volume of business the distributor earned from selling the supplier's goods and the distributor's dependency on the supplier's business.
- The time the distributor would need to replace the supplier's business and secure a similar source and level of income from a new supplier.
- The investment the distributor made to discharge its obligations under the distribution agreement.
- Industry practice.

In for cause terminations, the parties can agree by contract on default events that allow one or both parties to terminate the agreement with or without notice or an opportunity to cure. Canadian courts typically permit a distribution agreement that provides for termination when a specified event occurs to be determined when the event occurs.

Common default provisions that give rise to for cause termination without notice or an opportunity to cure include:

- A breach of a confidentiality obligation.
- An unlawful or unauthorized use or disclosure of third-party personal information.
- Conduct that harms the other party's reputation.
- Bankruptcy or other indications of serious financial hardship.
- Ceasing to do business in the normal course.
- The termination of another agreement between the parties.
- A party's unauthorized change of control or transfer of a substantial portion of its assets.

Where the distribution agreement does not expressly establish for cause default termination events, the contract can only be terminated for cause if there is evidence of a fundamental breach (in Québec, a serious or material breach). Absent established cause, reasonable notice must be provided to terminate the relationship.

The threshold for establishing a fundamental breach is high. The breach must go to the root of the contract or deprive the innocent party of substantially the contract's whole benefit (*Syncrude Canada Ltd. v. Hunter Engineering Co., 1989 CarswellBC 37 (S.C.C.)*)).

To determine whether a breach of contract meets the threshold for a fundamental breach, Canadian courts consider:

- The ratio of the party's obligation not performed to the whole obligation.
- The seriousness of the breach to the innocent party.
- The likelihood of repetition of the breach.
- The seriousness of the consequence of the breach.
- The relationship of the part of the obligation performed to the whole obligation.

(1193430 Ontario Inc. v. Boa-Franc Inc., 2005CarswellOnt 5661 (Ont. C.A.), paragraph 50 and Shelanu Inc. v. Print Three Franchising Corp, 2003 CarswellOnt 2038 (Ont. C.A.) (ONCA), paragraphs 117-118.)

There are no statutory entitlements to compensation on the termination of a distribution agreement. Compensating the terminated party is not required if reasonable notice of the impending termination is provided. If the agreement is terminated without notice, provided the termination was not for cause, compensation equivalent to the reasonable notice period that would have been applicable in the circumstances of the parties' relationship is granted to mitigate the terminated party's losses. The compensation amount is based on the same considerations that inform the length of the notice period and any special or case specific facts.

If the distribution agreement is for a fixed term, the contract naturally expires at the end of the term, without penalty or any compensation payable to the distributor. However, if the parties elect to continue their relationship after the expiry of the term, it can be an implicit renewal or an extension of the contract for an indeterminate term. Care should be taken to ensure the contract addresses what happens in this scenario.

In Québec, like the rest of Canada, courts first seek to interpret and apply the express provision of the distribution agreement when evaluating the termination rights and obligations of the parties. Absent these express provisions, a distribution agreement can be deemed a contract for services, which is a contract where one person (the distributor) undertakes to carry out physical or intellectual work for another person (the supplier) or to provide a service for a price that the supplier commits to pay (section 2098, *CCQ*). A key consideration in concluding that a service contract exists is the absence of control exercised by the supplier over the distributor and the distributor's independence to establish its method of operations.

A supplier can unilaterally terminate a distribution agreement that is found to be a contract for service at any time with or without cause (section 2125, *CCQ*). On termination:

- The supplier's sole obligation is to pay the distributor its costs and the value of all services rendered up to the termination date.
- The distributor must refund the supplier for any advances it received that exceed the performed services.

To avoid an early or unforeseen termination, distributors operating in Québec should include in their agreements an express waiver by the supplier of Section 2125 of the CCQ.

To better control their exposure, parties can proactively include limitation of liability or fixed liquidated damages provisions in their agreements (under Québec law, a termination penalty) that expressly state the parties' minimum or maximum liability to one another in a termination. Limitation of liability and liquidated damages clauses are generally enforceable unless a court finds them unreasonable.

In Québec, the right to terminate a distribution agreement is intrinsically tied to the principle of good faith. Under the required duty of good faith, courts seek substantial reasons (serious reasons in the CCQ) for termination, such as a significant breach of the contract by the distributor.

Like other parts of Canada, Québec requires reasonable notice of termination be provided, which aligns with the obligation to exercise rights in good faith. However, certain circumstances can allow parties to terminate the distribution agreement without notice if expressly provided for in the agreement.

Notably, terminating a distribution agreement in bad faith is subject to judicial scrutiny in Québec. The party that acted in bad faith during termination is liable for their actions.

Parties should expressly prescribe their respective post-termination obligations in the distribution agreement. These obligations can include:

- The proper disposition of each party's tangible and intangible property.
- Cessation of use of all IP.
- The return or destruction of all confidential or proprietary information and materials.
- For the benefit of the supplier:
  - the payment of outstanding amounts due and owed on the date of the agreement's expiration or termination;
  - limitations or prohibitions on the markdown of goods (if the goods are being offered for re-sale to the public);
  - a right to repurchase any remaining inventory at a specified price; and
  - reasonable restrictive covenants, including non-compete and non-solicitation covenants (see Covenants not to Compete).
- For the benefit of the distributor:
  - delivery of goods ordered but not delivered before termination; and
  - cooperation and assistance from the supplier to transition the supply of goods or services to an alternate distributor.

Finally, Canadian law requires all parties to a contract to discharge their respective rights and obligations, including any termination rights afforded them, honestly and in good faith.

Antitrust and Competition Laws Issues Related to Termination

Under Canadian law, companies can refuse to do business with other entities, including by terminating a distributor or refusing to do business with one. Under competition laws, a supplier can independently decide to terminate one of its distributors for any reason and vice versa (see Refusal to Deal and Abuse of Dominance).

Other Considerations

Before entering into a distribution agreement, the parties should ensure they have completed their respective due diligence on the character, experience, and compatibility of their partner. Distribution arrangements are co-dependent and selecting the right partner is critical.

The parties should also thoroughly understand the regulatory framework impacting the specific product or services to be offered and which party bears the responsibility for compliance.

Both parties should also enlist the assistance of experienced legal counsel to advise them on the transaction and to prepare comprehensive, compliant, and enforceable agreements that adequately represent and protect their interests in all circumstances. Comprehensive and clear agreements make for strong, successful relationships and can help avoid complications in the future.