

litigation group bulletin

Good Faith is a Two Way Street

Manufacturers who sell products through distributors will be interested in a recent Ontario case. The case considers when a manufacturer may immediately terminate a distributor because it is not acting in “good faith”.

Canadian law recognizes that contracting parties owe each other a duty to act in “good faith” with one another. In most cases, it is the distributor who alleges that the manufacturer/supplier has breached this duty. The recent case of *1193430 Ontario Inc. v. Boa-Franc (1983) Ltee*, however, confirms that “good faith” is a two way street.

The plaintiff in *Boa-Franc*, Salem Hardwood Flooring, was the exclusive distributor of Boa-Franc’s pre-finished hardwood flooring in Ontario. Approximately four years after Salem became a Boa-Franc distributor, Salem’s owner sold his shares in Salem to Floorco – a company that manufactured unfinished hardwood flooring. As part of this transaction, Salem’s former owner became a director and the CEO of Floorco. He also assumed responsibility for Floorco’s retail operations and the development of new hardwood flooring products.

Salem and its former owner did not tell Boa-Franc about the transaction. When Boa-Franc heard rumours about it and made inquiries, Salem deliberately attempted to conceal the sale and mislead Boa-Franc. Boa-Franc understandably felt that the transaction put Salem in an impossible conflict of interest and terminated Salem’s distribution rights immediately. Salem then sued Boa-Franc, alleging that it had terminated the distribution agreement without cause.

The court dismissed Salem’s claim and found that Boa-Franc was entitled to immediately terminate the agreement. The court confirmed that while a distributor may act in a self-interested manner, “good faith” requires a distributor to at least have regard to the legitimate interests of the manufacturer when making decisions. The court concluded that Boa-Franc had a legitimate interest in the transaction between Salem and Floorco and that Salem did not consider those interests or deal honestly or reasonably with Boa-Franc. Accordingly, the court held that Salem’s breach of “good faith” gave Boa-Franc just cause to terminate the distributorship without notice.

The *Boa-Franc* decision may, in the right circumstances, be a useful precedent for manufacturers and suppliers when seeking to terminate a distributor who has acted in bad faith.

Written by Brad Hanna

A Cautionary Note

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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