Ask An Expert

CFA - Feb. 2009

Q. Are non-competition covenants enforceable?

It depends. The Supreme Court of Canada recently decided a case from Vancouver and said that the non-competition covenant was not enforceable.[1] In doing so it gave some guidance as to when such agreements would be enforced by the courts.

Firstly the court said that "The absence of a payment for goodwill as well the generally accepted imbalance in power between employee and employer justifies more rigorous scrutiny of restrictive covenants in employment contracts compared to those in contracts for the sale of a business."

When an owner sells a business and agrees not compete against the new owner for a reasonable period it is assumed that the payment received for the business compensates the old owner for giving up the right to compete. But this does not generally occur in employment contracts. Accordingly restrictive covenants against former employees will be looked at more closely by the courts.

Secondly restrictive covenants must be reasonable in scope. They may cover the geographic territory where the company presently conducts business and perhaps where it soon expects to do business; but they cannot cover areas where the company only hopes to do business in the future. They must be for a reasonable period of time; and they must apply only to the areas in which the company carries on business.

Another important principle is that the restrictions in the covenant must clear and certain. The former employee must be able to easily determine what activities are prohibited. This was the point made by the Supreme Court here.

In the case before the Supreme Court an insurance broker by the name of Mr.Shafron had sold his business and become an employee of the purchaser. The business was sold again but he received none of the proceeds. Then he left his job in Vancouver and went to work for a competitor in Richmond, just across the north arm of the Fraser River from the City of Vancouver.

The agreement that Mr. Shafron had signed said that he would not be employed in the business of insurance brokerage within the "Metropolitan City of Vancouver." The problem was that no such municipality has been incorporated. There is the City of Vancouver and there is the "Greater Vancouver Regional District." Yet it was clear that he had intended to be bound by some sort of restriction.

[1] Shafron v. KRG Insurance Brokers (Western) Inc., 2009 SCC 6 (January 23, 2009), available on line at: http://csc.lexum.umontreal.ca/en/2009/2009scc6/2009scc6.html .

Could the courts correct the error in the choice of words? Ultimately the Supreme Court said no. The primary concern was that it would introduce a great deal of uncertainty into such contracts.

It has been suggested that anywhere the court finds ambiguity it can re-write the clause. But how would the employee know where it was safe to take a job where there is such ambiguity?

And if the courts did this it would invite employers to impose unreasonable restrictive covenants on the employee. The only risk would be that a court might narrow it to something reasonable. And until clause was challenged in court the employer would have the benefit of an agreement that was overly restrictive.

So in this case the Supreme Court simply said that the term "Metropolitan City of Vancouver" was ambiguous and could not be rewritten. The claim of the former employer for breach of the covenant was dismissed.

Non-competition covenants are common in franchising. Even when they are between a franchisor and franchisee they need to be clear, certain and reasonable or they risk being held invalid. Obviously it is important to ensure that the geographical scope of the covenant is defined using the correct legal names of the areas referred to. But the more difficult problems are usually in defining the types of businesses and the business relationships that are restricted.

What is a clear and reasonable restriction with respect to a franchise system operating sushi kiosks? If the covenant said that a former franchisee could not own or be employed in any restaurant that might be clear, but would it be reasonable? If it prohibited owning a business that served sushi, what about an upscale Japanese style restaurant where sushi was just one of the dishes? A reasonable and clear restriction for a sushi kiosk might be to not own or operate, directly or indirectly, a business whose primary source of income is the sale of sushi and/or sashimi.

Properly drafted non-competition covenants are enforceable.

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