BEST PRACTICES WHEN DRAFTING RESTRICITVE COVENANTS

By: Nancy Shapiro, The Employment Law Boutique

A. Introduction

Employers commonly try to protect business interests, in part, by placing restrictions on departing employees from competing with, or soliciting the business of, the employer when they move on to new employment, through the use of restrictive covenants in employment contracts.

There are various forms of what we consider restrictive covenants, including non-competition covenants, non-solicitation covenants and confidentiality covenants.

Whether a restrictive covenant is enforceable, generally speaking, depends on the reasonableness of the clause. A balance must be struck between discouraging unnecessary restraint of trade and respecting the freedom to contract.

While a confidentiality covenant will generally be enforced without much stringent review, a non-competition clause is *prima facie* void on the grounds that it is a restraint on trade and contrary to public policy. The onus falls on the employer to justify the reasonableness and necessity of the covenant in question. The courts have been very cautious in enforcing post-termination restrictions. Further, since October 2021, there have been legislated limits imposed in Ontario on the use of non-competition restrictions.

This paper traces the modern law on restrictive covenants including: the early decision in *Elsley;* the more recent articulations from the Supreme Court of Canada in *RBC* and *Shafron;* judicial pronouncements over the last couple of years; the different treatment of restrictive covenants in commercial contracts versus employment agreements; the impact of the legislation around non-competition covenants; and finally, best practices for drafting restrictive covenants.

B. The Long - Established Principals

The Beginning: *Elsley v. J.G. Collins Insurance Agencies Ltd.*

The present-day law on restrictive covenants dates back to the 1978 decision of the Supreme Court of Canada in *Elsley v. J.G. Collins Insurance Agencies Ltd.*[1] The parties entered into an agreement for the purchase of the general insurance business owned by Elsley. The purchase agreement included a covenant that restricted Elsley from carrying on or being engaged in the business of a general insurance agency within the city of Niagara Falls for a period of ten years. The parties also entered into an employment agreement pursuant to which Elsley worked as a manager of Collins' general insurance business. The employment agreement included a restrictive covenant which would apply for a five-year period after Elsley's cessation of employment, as follows:

> 3. Subject to the restrictive covenants contained in the Agreement made between the Parties dated May 1, 1956, in consideration of the employment, the Manager shall not, while in the employ of the Company or of its successors and assigns, whether in the capacity in which he is now or in any other capacity, or during the period of five years next after he shall, whether by reason of dismissal, retirement or otherwise, have ceased to be so employed, directly or indirectly, and whether as principal, agent, director of a company, traveller, servant or otherwise, carry on or be engaged or concerned or take part in the business of a general insurance agent within the corporate limits of the City of Niagara Falls, the Township of Stamford and the Village of Chippawa, all in the County of Welland; and in the event of his failing to observe or perform the said agreement, he shall pay to the said Company, its successors or assigns, or other the person or persons entitled for the time being to the benefit of the said agreement, the sum of One Thousand Dollars ($1,000.00) as and for liquidated damages, and the said Mrs. Elsley, wife of the Manager, by her signature hereto, agrees to observe and be bound by the aforesaid covenant.

After almost 17 years, the employment relationship was terminated. Shortly thereafter, Elsley commenced his own general insurance business. A number of former clients of the Collins' company transferred their business to Elsley.

The Court articulated a number of factors to be considered in deciding whether a restrictive covenant in an employment contract is void as being a restraint on trade:

(1) whether the employer has a proprietary interest worthy of protection;

(2) whether the covenant is reasonable in terms of duration and geographic scope; and

[1] 1978 CanLII 7 (SCC)

(3) whether the covenant restricts competition generally, or bars solicitation of the former employer's clients.

The Court noted that the restrictive covenant in the purchase agreement was exhausted. Although the Court held that the restrictive covenant in the employment agreement was valid as it was not broader than reasonably required to give adequate protection to Collins, it emphasized that a clear blanket restraint on freedom to compete or any unreasonable restraint will be held to be unenforceable. The concept of only allowing for a non-competition covenant at all where a non-solicitation covenant would not provide adequate protection stemmed from this case and is a core legal principle in the enforcement of restrictive covenants in the non-competition law area. Justice Dickson emphasized that only where the nature of the employment is "exceptional" will a covenant prohibiting an employee from competing be enforced. In this case, a non-solicitation was held to be inadequate and the non-compete was enforced. The court upheld the damage award of $1,000 and the injunction which had been granted.

While these principles remain the law to this day, the use of a five-year non-competition restriction in an employment agreement on the same facts would not likely be enforced today. The courts have become more rigorous in their approach to enforcement of restrictive covenants in employment agreements since the *Elsley* decision.

SCC Decisions - RBC* and *Shafron

In 2008-2009, the Supreme Court of Canada dealt head-on with the issues of departing employees' rights to compete with their former employer, the legitimacy of non-solicitation and non-competition agreements and the Court's role in construing these provisions in employment contracts; these were the cases of *RBC v. Merrill Lynch* and *Shafron v. KRG Insurance Brokers.*

RBC v. Meri11 Lynch[2] was memorable for its facts. In November 2000, the branch manager of a RBC investment brokerage business in B.C. coordinated the departure of nearly all of the investment advisors to a competitor business run by Merrill Lynch. No notice was provided by the advisors, and in the period leading up to the mass exodus, many of RBC's records were copied and transferred to Merrill Lynch. RBC sued the branch manager, the former employees and Merrill Lynch, seeking damages for a number of alleged wrongs, including breach of fiduciary duty,

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[2] 2008 SCC 54

breach of implied terms including not to compete and to provide reasonable notice, among others.

The Supreme Court of Canada made it clear that once the investment advisors left RBC, they were under *no* general duty *not* to compete with their former employer. There is no blanket prohibition on competition by a former employee. An employer's recoverable damages are limited to the employee's failure to give reasonable notice and specific breaches of their duties, such as improper use of confidential information. This general freedom to compete may be restrained by the duty not to misuse confidential information, as well as duties arising out of a fiduciary status or a restrictive covenant. Justice McLachlin for the majority specifically declined to consider whether managerial employees have "quasi-fiduciary" duties. At paragraph 19, the Court summarized as follows:

> ...The contract of employment ends when either the employer or the employee terminates the employment relationship, although residual duties may remain. An employee terminating his or her employment may be liable for failure to give reasonable notice and for breach of specific residual duties. Subject to these duties, the employee is free to compete against the former employer.

The Supreme Court of Canada ultimately reinstated most of the trial judge's award, which assessed damages against the departing employees and found Merrill Lynch jointly and severally liable for the award.

Approximately one year later, in 2009, the Supreme Court of Canada released *Shafron v KRG Insurance Brokers (Western) Inc* .[3] After selling the shares of his business, Shafron continued to be employed by KRG under a series of employment contracts for a period of over 10 years. Each successive employment agreement contained a restrictive covenant stating that if Shafron were to leave KRG for any reason except termination without cause, he would not be able to carry on or be employed in connection with the business of insurance within the "Metropolitan City of Vancouver" for a period of three years. After Shafron joined another insurance agency in Richmond, a suburb of Vancouver, KRG brought an action attempting to enforce the restrictive covenant and claiming that he had breached equitable and fiduciary obligations.

The Supreme Court started with the proposition that non-competition covenants are restraints of trade and generally contrary to public policy. However, parties have the freedom to contract and agree to terms that are reasonable. The term "Metropolitan City of Vancouver" in the non-

[3] 2009 SCC 6

competition clause was not a legally defined term and as a result caused the parties to disagree on its particular meaning. The Court held that an ambiguous or unreasonable clause in an employment contract is void. Further, the British Columbia Court of Appeal erred in trying "to resolve the ambiguity in the term "Metropolitan City of Vancouver" by reading down the covenant according to its notion of reasonableness and what it thought the parties might have intended".[4] The Court explained that it will not re-write or sever a clause in an agreement to assist the parties in general and the employer in particular:

> [33] Where the provision in question is a restrictive covenant in an employment contract, severance poses an additional concern. While the courts wish to uphold contractual rights and obligations between the parties, applying severance to an unreasonably wide restrictive covenant invites employers to draft overly broad restrictive covenants with the prospect that the courts will only sever the unreasonable parts or read down the covenant to what the courts consider reasonable.

As there was "no evidence that the parties unquestionably would have agreed to remove the word "Metropolitan" without varying any other terms of the contract or otherwise changing the bargain", blue-pencil severance could not be applied. The Court did, however, leave open the possibility that blue-pencil severance *could* be applied to a restrictive covenant in very narrow circumstances:

> [36] ….I am of the opinion that blue-pencil severance may be resorted to sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purpose of the restrictive covenant. However, the general rule must be that a restrictive covenant in an employment contract found to be ambiguous or unreasonable in its terms will be void and unenforceable.

The appeal was allowed, concluding that "Metropolitan City of Vancouver" was ambiguous and reversing the Court of Appeal's error in re-writing the restrictive covenant. Blue penciling of employment restrictive covenants has not been adopted in any subsequent cases as an acceptable practice.

In the Ontario Court of Appeal's decision in *Veolia ES Industrial Services Inc. v. Brule*[5], a non-competition clause was scrutinized and the Court emphasized that rectification of a contract is to be used with great caution. In accordance with *Shafron,* blue-pencil severance is only available if after a part is severed what remains can "fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agree do it without varying any other

[4] at para. 47
[5] 2012 ONCA 173

terms of the contract or otherwise changing the bargain."[6] Further, blue-pencilling should only be used in cases to sever merely trivial or technical parts of an invalid covenant, not forming part of the main implication of the clause. The phrase sought to be severed was held not to be trivial, and there was evidence that the parties would not have agreed to sever these words without varying the terms of the contract or changing their bargain.

In summary, these cases tell us that a non-competition covenant is *prima facie* unenforceable unless the employer can show the clause is reasonable with respect to the parties and with reference to public interest. Specifically, "rigorous scrutiny must be applied to non-compete clauses in the employment context" where an imbalance of bargaining power exists between the parties. The factors to consider in enforcement and hence drafting are:

- Geographic location
- Period of effective time
- Extent of activity the employer seeks to prohibit

Further, restrictive covenants must be interpreted and enforced in their entirety. There is no “blue penciling”.

C. The Fundamental Principles of Restrictive Covenant Interpretation which followed:

(a) Departing Employees' Obligations — Confidentiality is Absolute

In *Service Corporation International (Canada) Ltd. (Graham Funeral Home Ltd.) v. Nunes-Pottinger Funeral Services & Crematorium Ltd.*[7], a long-serving manager resigned his employment to establish a competing funeral home business in a small community. The only other full-time employee, along with all part-time employees, resigned simultaneously and joined the new enterprise. Upon their departure, the employees took copies of 2/3rds of the "pre-need" funeral services contracts and were ultimately successful in transferring the contracts to the new business. There were no written employment agreements at issue, but the Court had to consider the nature and scope of the obligations of the two key employees following their resignation.

The Court affirmed the principle articulated in *RBC* that every employee, whether or not in a fiduciary relationship to the employer, owes a duty of fidelity or good faith to the employer which

[6] *Ibid a*t par 28.
[7] 2012 BCSC 586

extends beyond active employment. The Court did not hesitate to conclude that the taking and using of confidential information was clearly a breach of the departing employees' duty of good faith and confidentiality:

> I find that Messrs. Nunes and Pottinger were in clear breach of their duty not to misuse confidential information obtained from their former employer. When a new employer benefits from the misuse of confidential information, that new employer is also liable for the former employer's losses, even if it had no direct knowledge of the employees' breach of duty: *Clayburn Industries Ltd. v. Piper* 1998 CanLII 6544 (BC SC), (1998), 62 B.C.L.R. (3d) 24 (S.C.). The case for liability of the new employer, NP, is particularly strong here because Mr. Nunes and Mr. Pottinger were not merely new employees, but the directing minds of NP, which clearly benefited from the transfer of business.[8]

This case reinforces the principle that former employees are restrained from certain activities even in the absence of any written employment agreement or fiduciary relationship and that the new employer will be liable for their ill-gotten gains.

(b) Departing Employees' Obligations — Non-Solicitation Injunctions Will Not be Readily Granted

In *Edward Jones v. Voldeng*[9], an employer sought an injunction against two former employees who left to join a competing investment advisor firm. Prior to commencing employment, Voldeng signed an employment agreement that stated as follows:

> 11. For a period of six months following termination of this Agreement, you will not directly or indirectly solicit sales of securities and/or insurance business to or from any customer of Edward Jones or otherwise induce any said customer of Edward Jones to terminate his/her relationship with Edwards Jones, if you contacted or dealt with such customer during the course of, or by reason of, your employment with Edward Jones or if the identity of such person was learned by you by reason of your employment with Edward Jones. You further agree that, while in the employ of Edward Jones and for a period of six months after termination of employment with Edward Jones, you will neither confer nor discuss with any Edward Jones' employee the subject of leaving the employ of Edward Jones, nor shall you confer nor discuss with any Edward Jones' employee the subject of employment by a person or organization engaged in a similar, related, or competing line or lines of business. It is understood and agreed that the identities of and information concerning the customers of Edward Jones are confidential information, constitute a trade secret, and are the sole and exclusive property of Edward Jones.

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[8] *Ibid a*t par 37.
[9] 2012 BCSC 497, appeal 2012 BCCA 295

A day after Voldeng and his assistant resigned from employment, Voldeng sent an email to a number of former clients announcing his departure and promising to touch base in the coming days. Evidence established that Voldeng subsequently called a number of clients and many transferred their investments to Voldeng's new employer, RBC.

Edward Jones obtained an interlocutory injunction that prohibited Voldeng from initiating any contact with any former client for six months. In the BC Court of Appeal, the key issues were whether there was evidence of "irreparable harm" and whether the balance of convenience favoured granting the injunction. Voldeng successfully argued that the harm flowing from a breach of non-solicitation covenants differs from breaches of non-competition covenants. The BC Court of Appeal stated:

> [36] The cases illustrate the general rule that the harm flowing from the violation of non-solicitation clauses usually differs from that which flows from the violation of non-competition clauses. The damages that flow from a violation of a non-solicitation covenant in the employment contract of an investment advisor generally are calculable because the industry is regulated heavily. The value of the portfolio of a departing client is known, as is the return to the brokerage firm of managing that portfolio. The evidence in this case illustrates the point. The respondent is able to state exactly the value of the accounts of Mr. Voldeng's former clients that have been transferred to RBC. As the chambers judge noted, the evidence before her showed that accounts totalling an approximate value of $4 million had been transferred to RBC. In a statement of facts filed on this appeal, the parties agreed that as of April 13, 2012, the respondent had received instructions to transfer client accounts with the approximate total value of $20.2 million. In my view, in this case the potential damages arising out of solicitation, being calculable, do not constitute irreparable harm.

The BC Court of Appeal concluded that Voldeng's solicitation did *not* constitute irreparable harm because Edward Jones was able to calculate its precise financial loss. In doing so, the Court cautioned that while most improper solicitations may result in calculable damages, "it must not be assumed that all will." This case is a cautionary tale for employers who want to take immediate action via injunction against a former employee. Injunctions will be granted sparingly and seeking damages is usually a better path.

(c) Do Not Use Overly Broad Clauses

In *Mason v. Chem-Trend Limited Partnership*[10] the Ontario Court of Appeal considered the enforceability of an expansive restrictive covenant in the employment contract of a long-serving employee terminated without cause. Mason was a technical salesperson for Chem-Trend, an American-based company selling chemicals to the rubber and plastics industry, for 17 years. The covenant in question provided that Mason would not, *`for a period of one year following the termination, directly or indirectly, for my own account or as an employee or agent of any business entity, engage in any business or activity in competition with the Company by providing services or products to, or soliciting business from, any business entity which was a customer of the Company during the period in which I was an employee of the Company, or take any action that will cause the termination of the business relationship between the Company and any customer, or solicit for employment any person employed by the Company'.*[10]

The Court of Appeal agreed with the lower court decision that the wording of the restrictive covenant was unambiguous but did not agree that the covenant was reasonable. First, preventing the appellant from dealing with *any* customer of Chem-Trend during his 17 years of employment would make it impossible for him to identify with whom he was permitted to do business. Second, the appellant's position in the company of a sales person was not comparable to an executive who would have significant knowledge of Chem-Trend's client base. The Court of Appeal held that the covenant was unenforceable as it was ambiguous and overly broad.

The Court of Appeal made some notable comments on the geographic scope of the restrictive covenant, which are relevant to the increasingly globalized economy:

> [20] The application judge recognized that the respondent has trade secrets, confidential information and trade contacts that are entitled to protection. These included not only product [page78] information, but information about customers' needs and pricing arrangements with the company that give it a competitive advantage. **Because of the worldwide nature of the business entities in issue, he found the lack of any spatial limit in the restrictive covenant to be appropriate.** He also observed that the temporal limit on competition of one year is relatively short compared to some other covenants that have been upheld. **[emphasis added]**

[10] 2011 ONCA 344 at para. 3

(d) Fines for Breach will be subject to the Same Scrutiny and must be Reasonable – Not Longer than was the Duration of Service

The British Columbia Court of Appeal considered whether not baring competition but putting a price on doing so would be acceptable in *Rhebergen v. Creston Veterinary Clinic Ltd.*[11], the employee was a veterinarian and started working at the Creston Veterinary Clinic in January 2010. She entered into an "associate agreement" that included a clause which did not prohibit her from setting up a competing practice but required her to pay a fixed sum of $150,000, $120,000, and $90,000 in the event she did so within one, two or three years of termination of the contract, respectively. The employee plaintiff took the position that the clause was in all respects a restrictive covenant and was unreasonable as the temporal restriction was too long and the geographical scope was overly broad. She further asserted that the term "sets up a veterinary practice" in the non-competition clause was ambiguous, and contrary to public policy. The defendant took the position that the impugned clause was not a restrictive covenant or a non-competition clause "in the true sense" as it does not prevent the plaintiff from practicing veterinary medicine within the defined radius or from soliciting the defendant's clients. Rather, it put a price tag on doing so.

The Court concluded that the non-competition clause was unenforceable for a number of reasons. First, the Court followed the principle in *Shafron* holding that notional severance does not apply to restrictive covenants in employment contracts. The phrase "sets up a veterinary practice" can have several different meanings and is therefore ambiguous and unreasonable. Courts will not "fix" a restrictive covenant to make it reasonable and enforceable. Second, with respect to the nature of the activities prohibited, the Court held that this case did not fall into the "exceptional category" articulated in *Elsley* justifying a non-competition clause. The clause imposed an unreasonable restraint on trade, even if the terms were not ambiguous. Third, on the issue of temporal scope, the Court found that the duration of the clause was 2.5 times longer than the duration of the plaintiff's employment and as a result was too long.

A majority of the Court of Appeal dismissed the employer's appeal holding that the non-competition clause was unreasonable and constituted a restraint of trade.

[11] 2014 BCCA 97

(e) Indeterminate Time Frame will Result in no Enforcement

The Court of Appeal has made it clear that restrictive covenants that are indeterminate in terms of time frame are unreasonable. In *Martin v. ConCreate USL Limited Partnership*[12], the central issue on appeal was whether the duration of the general non-competition and non-solicitation covenants in an agreement was ambiguous or otherwise unreasonable and therefore unenforceable. The covenants had been entered into by Martin in connection with a previous sale of the business by Martin and other stakeholders, after which he stayed on as President. Later, Martin's employment was terminated, and he established a competitive business. The enforceability of the restrictive covenants thus became an issue.

Martin was the President and a minority shareholder of ConCreate and a related business, Steel Design & Fabricators. As part of the sale of Martin's businesses to TriWest, he signed a Limited Partnership Agreement and Employment Agreement that contained three types of restrictions: a general non-competition covenant, a restriction on soliciting, and a prohibition on the use of any non-public information pertaining to ConCreate. Martin's employment was terminated less than six months after the closing of the sale transaction. Eight days after being terminated, Martin started a company, which employed a number of former ConCreate employees. Of note, two of the employees were former members of ConCreate's management team. ConCreate brought an action against Martin for breach of the restrictive covenants and his fiduciary duties. In response, Martin applied for a declaration that the covenants were void and unenforceable as being in restraint of trade.

The agreements provided:

> -the “Prohibited Period” – ends 24 months after Martin disposes of his direct or indirect interest in the Units. However, both MartinCo’s ability to dispose of its Units, and changes in the ownership of MartinCo, are restricted by the Partnership Agreement.
>
> -Any transfer of the Units is subject to any required consents of the Lenders, which is defined in the Partnership Agreement to include the respondents’ and their subsidiaries’ senior secured lenders and bonding companies from time to time. This includes transfers to a third party, or the exercise of TriWest LP’s right to purchase the units or Martin’s right to require the repurchase of his units following the end of Martin’s employment. A transfer of

[12] 2013 ONCA 72

Units also requires the approval of the board of directors (the "Board") of TriWest Construction (GP) Inc., the general partner of TriWest LP.

-A change in the ownership of MartinCo was similarly subject to required consents, including the consent of the Board.

The Court of Appeal held that the duration of the restrictions was unreasonable. Since the duration depended on the consents of third parties and the fact that there was no fixed limit of duration, the restrictive covenant was unreasonable. The Court's decision acknowledges the appropriateness of restrictive covenants entered into in connection with a business sale, but the Court held that particular covenants in this case were not enforceable because they lacked a clear, outside limit to the duration of the non-competition and non-solicitation period (and could have been too long, essentially).

(f) Burden of Proof is on the Company and Timing of Assessment

We also know that the employer seeking to enforce a restrictive covenant bears the onus of establishing on a balance of probabilities "that it has a proprietary interest entitled to protection, that the temporal and spatial features of the clause are not too broad, that the terms are clear and certain, not vague and ambiguous" and that the restriction is reasonable. The reasonableness of the covenant is determined in light of the circumstances at the time the contract is executed which, of course, includes the parties' expectations of what "might possibly happen in the future".[13]

(g) For Non-Solicitations Contact must be "Material"

Courts have also repeatedly held that non-solicitation covenants must have a connection between those who are not to be solicited and the person being barred from soliciting. Covenants which over-reach and ban a solicitation of "all customers" in circumstances in which the former employee only had contact with a percentage of customers will not generally be enforced. The freshness of the customer relationship is also important; a customer from 10 years ago, for example, is not a fair restriction. The courts have held that employees must be able to ascertain the customers who are "off-limits" to them. The covenants also must not be so broad as to operate as a non-compete (such

[13] *Ceridian Dayforce Corporation v Daniel Wright*, 2017 ONSC 6763 at para. 39 & 40 citing as authority: *Tank Lining Corp. v. Dunlop Industries Ltd.*, 1982 CanLII 2023 (ON CA), [1982] O.J. No. 3602, 140 D.L.R. (3d) 659 (C.A.), at para. 18.

as where “any potential customer” is the restricted non-solicit language or the covenant seeks to restrain acceptance of business even if it was not solicited).

The proposition that, in order to enforce a restrictive covenant in the employment context restraining solicitation of customers, the employee's contact with those customers must have been material, originated in *Elsley v. J.G. Collins Inc.*[14] The Court noted that the enforceability of such covenants depends on whether the employee had a significant relationship with the customers in question, such that the employee's departure (and competitive activities) could harm the employer's business.

In *Mason v. Chem-Trend Limited Partnership*[15], the Ontario Court of Appeal reiterated that a valid non-solicitation clause must clearly identify the customers who are off-limits and that the employee's contact with those customers must have been substantial enough to justify the restriction. This ensures that the covenant is not overly broad and is directly tied to the employee's role and influence within the employer's business.

These cases collectively establish that the materiality of the employee's contact with customers is a critical factor in determining the enforceability of restrictive covenants in the employment context, balancing the employer's need for protection with the employee's right to earn a livelihood.

(h)*The Enforceability of Restrictive Covenants in the Commercial Context*

(i) Agreements of Purchase and Sale

It has long been recognized that the rules applicable to restrictive covenants differ depending on whether the covenants are linked to a contract for the sale of a business or to a contract of employment. In *Elsley*, Dickson J. emphasized the importance of this distinction because the balance of bargaining power in these scenarios differs. In the context of negotiating an employment agreement, the imbalance of bargaining power between the employer and employee can lead to oppression and deny the right of the employee to exploit the knowledge and skills obtained during employment.[16]

In the commercial context, however, there is no presumption of an imbalance in bargaining power between a vendor and purchaser since the parties have greater freedom to contract. This principle

[14] *Supra* note 1
[15] 2011 ONCA 344
[16] pg. 924

was affirmed in a 2013 decision *Payette v. Guay*[17] where the Supreme Court of Canada held that the rules surrounding restrictive covenants relating to employment do not apply with the same rigour or intensity in the context of a commercial contract.

In *Payette,* both the appellant and the respondent were involved in the crane rental business. Payette with his business partner controlled several companies ("Groupe Fortier"). The respondent agreed to purchase Groupe Fortier's assets and Payette agreed to work full time for the respondent as a consultant for a six-month period following the closing of the transaction. The Agreement of Purchase and Sale included both non-competition and non-solicitation clauses, restraining Payette and his business partner from competing with Groupe Fortier for a period of five years following employment. Payette's employment was continued beyond the initial six months, but was terminated a few years later without cause. He accepted new employment with Mammoet Crane as Operations Manager. Within days after Payette started his new job, Groupe Fortier lost seven of its most experienced employees to Mammoet. As a result, the respondent filed a motion for an interlocutory injunction to require Payette to comply with the restrictive covenant in the Agreement of Purchase and Sale.

The Supreme Court of Canada confirmed that a non-competition covenant in a commercial context will be found to be lawful and reasonable provided that it is "limited, as to its term and to the territory and activities to which applies, to whatever is necessary for the protection of the legitimate interests of the party in whose favor it was granted."[18] The Court explained that in the commercial context restrictive covenants are generally lawful, unless contrary to public order. However, the covenant must still be interpreted in a manner consistent with the obligations to which the covenant gives rise and with the intention of the parties.

(ii) Dependant Contractor Agreements

Fonkalsrud v. Boxall[19] is illustrative of the operation of non-competition agreements in the context of small, independent business owners in a subcontractor situation, where "reasonableness" may be measured against a less exacting standard than in the employment context. The plaintiff was the owner of a therapy and wellness clinic in downtown Regina. The defendant was a registered massage therapist who worked at the clinic and signed a "Therapist Agreement" containing the following clause: "the therapist agrees not to work or provide services of any kind similar to those

[17] 2013 SCC 45
[18] at para. 9 & 61
[19] 2013 SKPC 116

provided from the Premises within a 1 kilometre radius of the Premises upon termination of this Agreement for a period of two years." After nearly six years of working together, the defendant left and soon established her own massage clinic.

The plaintiff sought damages against the defendant for breach of the non-competition clause in the Therapist Agreement. The defendant disputed the plaintiff's claim and argued that the plaintiff had no valid proprietary interest to protect, but even if she did, the clause was unenforceable because the spatial and temporal scope of the non-competition clause is overly broad. More importantly, the defendant alleged that the clause is against public policy as its sole purpose is to place a restraint on trade and eliminate competition.

The Court noted that the Therapist Agreement was not an employment agreement, but rather an agreement between a sole proprietor and an independant contractor. The Court was satisfied that the clients originally developed by the plaintiff (and eventually transferred to the defendant) constitute trade connections to which a proprietary interest attaches. The Court held that the spatial features of the clause were not overly broad. The Court considered *Shafron* and whether it was necessary to "blue line" the agreement to reconsider the clause in the context of a walking distance rather than as the "crow flies radius" to resolve ambiguity, but found no ambiguity to exist. In the result, the Court upheld the non-competition clause and found the defendant in breach and ordered damages in the amount of $20,000 payable to the plaintiff.

This issue arose again recently in the Court of Appeal decision in *Dr. C. Sims Dentistry Professional Corporation v. Cooke*[20]. In this case, Dr. Sims, through his PC had purchased the shares of the dental practice of Dr. Cooke. This was a practice which Dr. Cooke had operated for roughly 30 years. As part of the sale, Dr. Cooke agreed to stay on as an associate for a minimum of period of two (2) years, subject to termination on 90 days' notice.

Dr. Cooke also agreed to a non-solicitation/non-competition provision (both as part of the Share Purchase Agreement and in the form of a stand-alone agreement in identical terms) that contained a clause prohibiting him from directly or indirectly engaging in the practice of dentistry, or permitting his name to be used in such a practice, for a period of five years following his association with the Practice within a radius of 15 km of the Premises (the "Non-competition Covenant").

[20] 2024 ONCA 388

The Court of Appeal agreed that in the context of a commercial transaction, the starting presumption is that the Non-Competition Covenant is enforceable.[21]

The Court was not persuaded that Dr. Cooke's intentions in terms of how long he would work and his retirement plans were relevant to the assessment of enforcement. It said:

> [20]…The issue was the reasonableness of the Non-competition Covenant in protecting the business that had been sold from competition by Dr. Cooke, both in his continuing to work as a dentist, and otherwise in engaging in activities that would trade on the goodwill of the business. The purpose of a restrictive covenant is to protect the goodwill of a business that is sold from being devalued by the vendor's own actions – in essence to ensure that the vendor does not derogate from his grant. Goodwill encompasses not only the existing customer base but also the ability to attract new patients from within the area served by the business or its "marketplace": see *Tank Lining*, at p. 226.

The Court considered the geographic scope of the covenant and found a 15 km radius of the practice in Hamilton was reasonable given the circumstances of the case and the reasonable travel distance. Five years was found to be a reasonable duration. The covenant was enforced.

(i) Professionals and Non-Competition Covenants in Employment Agreements

We can contrast the contractor decision above to one in an "employed associate" context, also in dentistry, outside of any commercial transaction. The Ontario Court of Appeal in *Lyons v. Multari*[22] considered the enforcement of a protective covenant of "3 yrs – 5 mi." and whether this should be enforced or whether a non-solicitation covenant would have been adequate, which was what the case here turned on.

The court found that as two professionals, the relationship was "one between equals", unlike many employment situations in which there will be unequal bargaining power. The employer dentist had over the course of the relationship introduced the associate not only to patients but also referral sources. Nevertheless, the court held that a non-solicitation covenant would have been sufficient and that this was not a "special" enough situation to justify a non-competition provision. The associate played the role of "a normal associate"; he did not manage the practice and was there for a relatively short period of time (less than 2 years). The associate simply handled patients referred to him and he was not the "front man, or

[21] *Ibid* par. 16
[22] 2000 CanLii 16851

principal contact person" communicating with referring dentists. He was not the "personification of the practice". Further, the non-competition could not be enforced on the basis of necessity to the protection of confidential information. The court made it clear that professional associates cannot be subject to non-competition in run of the mill situations such as this one.

D. The *Employment Standards Act, 2000* ("ESA") – 2021 Amendment[23]

The ESA does not prohibit non-solicit clauses or address them at all. It does, however, provide restrictions on non-compete agreements for employees in Ontario. These restrictions came into effect on October 25, 2021, and only apply to agreements signed after that date.

The ESA expressly acknowledges that non-compete as permissible if:

1) there has been the sale of a business, and the employee was an owner; or

2) the employee is an "executive", meaning C-suite.

Otherwise, no enforceable employment non-compete can be entered into after October 25, 2021. There has not been retroactive impact to this legislation.[24] The restriction would include placing such non-compete provisions in any employment-related documents, including long-term incentive plans. Restrictive covenants that are not prohibited by the ESA still remain subject to existing common law principles regarding enforceability.[25]

However, executive compensation is the big "minefield". You may find restrictive covenants in any number of executive compensation plan agreements. Equity grants typically are accompanied by a Grant Agreement. Often there will be some other form of master incentive plan agreement too. If there are stock options which result in the employee's share ownership in a privately held company, there is usually a Shareholders Agreement. Deferred cash compensation is also subject to written terms. Carried Interest Plans will have plan terms, fund terms and/or partnership agreements.

As a result of the 2021 ESA amendment, businesses are now turning towards more innovative strategies to ensure post-employment compliance and retain their top talent.

[23] Part XV.1 was added to the ESA 2000 by the *Working for Workers Act, 2021* (WFWA). Although the WFWA received Royal Assent on December 2, 2021, Part XV.1 was deemed to have come into force on October 25, 2021
[24] *Parekh et al v. Schecter et al*, 2022 ONSC 302
[25] See *M & P Drug Mart Inc. v. Norton*, 2022 ONCA 398, and *Giacomodonato v PearTree Securities Inc.*, 2023 ONSC 3197

There has been a movement in the business community to use covenants that punish competition, not as a bar to competing *per se*, but as a financial deterrent where competition results in forfeiture or repayment of a payment. Although it is based on old case law, this emerging trend is "the new golden handcuff of long-term incentive compensation."

While previously, the majority of companies seemed to find ways to draft governing documents to ensure employees would not obtain any payment after termination (or at least following the minimum period required by statute), now increasingly, we are seeing continued payment as long as the executive "plays by the rules".

These restructured incentives involve tying continued payment of compensation post-termination—such as stock options or performance-based bonuses—to continued adherence to certain post-employment conditions such as non-competition, non-solicitation or confidentiality agreements. While this approach sidesteps outright bans on competition, the legal landscape remains murky. There are no cases to-date that have considered whether or not this violates the non-competition amendments to the ESA.

E. Best Practices for Drafting Restrictive Covenants

Drafting restrictive covenants requires the same thoughtfulness and simplicity applicable in any good legal drafting. The case law provides some guidance as to what will be considered ambiguous and unreasonable and how courts will resolve these contractual disputes, but employers should start from the premise that such covenants are presumed void on their face. Here are some factors to reflect on and pointers for drafting:

- Consider what legitimate business interests need protection and how this can be achieved;
- Determine if a non-competition clause is in fact necessary, where a non-solicitation and/or non-disclosure clause would otherwise provide adequate protection;
- Be precise about the duration of the restrained activity: do not leave the period of time for the restrictive period to run contingent on any future events, open-ended, or for longer than is strictly necessary, and it should be proportionate to the duration of the employment. The time period should also be easily understood by anyone reading the clause;
- Consider duration relative to length of service;

- Be clear about the activity that is restrained and who it applies to: list the type of activity or activities that are prohibited during the relevant period, including examples where helpful. An employee reading the clause must be able to know what type of activity is prohibited and/or what specific persons may not be solicited;
- Non-solicitation agreements should define clearly who they apply to and be narrow enough to include only customers known to the employee with whom there was material contact;
- The geographical scope of the restrained activity should be defined, if appropriate;
- Ensure that the restrictive covenant does not unnecessarily restrain an employee from using her experience, skills and talent in the future;
- If the employee is also party to a commercial contract, ensure that the non-competition and/or non-solicitation clause is also contained in the commercial agreement; and,
- Clarity is key – ambiguity is fatal.