Restrictive Covenants In Employment Contracts:

The Latest Developments You Need to Know to Protect Your Interests

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Introduction

1. Consider the following hypothetical: John goes to an interview for his dream sales position. An hour in, he is fast friends with the owner and other sales people. John feels like he has known them his whole life. A second interview is scheduled, but that is only a formality. An employment contract is signed. There is some discussion of obtaining independent legal advice and what would happen if John were to leave the company, but John and the owner are too caught up in the situation to go into much detail. For John, this is the break and the stepping stone that will change his life. For the owner, he has finally found the person who will make his company reach its potential.

2. Ten months later, John is served with a Statement of Claim and a Notice of Motion for an Injunction. After six months, John accepted a similar job from a competitor, the contact whom he met at a company golf tournament. John's departure, while ultimately was of his own choosing, had become inevitable. John could not stand going in to work every day and unbeknownst to John, the owner had already sought advice concerning John's termination. At his new company, John received orders from clients of his old company; no one can remember who called the other first. John finds a copy of his employment contract which stated in one paragraph that he could not compete for one year within south-western Ontario and in another paragraph that he could not solicit any clients of his old company that were within south-western Ontario for a period of one year. The old owner seeks an injunction enforcing the restrictive covenant which was part of the employment contract. In addition, the Statement of Claim seeks substantial damages, both liquidated and punitive, against John and his new company. John's new boss comes into his office and asks John why he has just been served.

3. This paper will discuss the latest developments with restrictive covenants and how you can best protect the relative interests in employment contracts. Part 1 will discuss the latest cases on restrictive covenants, how courts apply the blue-pencil rule and how highly mobile employees are dealt with in geographic boundary cases. Part 2 will analyze the best method to protect your interests, either through a non-competition clause, non-solicitation clause or confidentiality agreement. Part 3 discusses how to draft a reasonable non-competition clause and the likelihood of enforceability. Finally, Part 4 analyses when it is appropriate to enforce the restrictive covenant and when you should seek an injunction.

Part 1: Blue Penciling - before and after *Shafron* (2009 SCC 6)

4. The "blue-pencil test" refers to a judicial standard for deciding whether to invalidate the whole of a contract or only the offending words.[3] The court decides whether the contract as a whole can be saved by running a line through offending words. Classically, using this test, words are not changed, added or rearranged.

5. In a different context, the blue-pencil rule was discussed and significantly enhanced by Arbour, J. in *Transport North American Express Inc. v. New Solutions Financial Corp.*, [2004] 1

3 Black's Law Dictionary, 7th ed, (St. Paul: West Group, 1999) at 166.

S.C.R. 249 (S.C.C.) The case dealt with an illegally high interest rate at paras. 28 and 30:

> The use of the blue-pencil approach to sever one or more provisions from a contract alters the terms of the agreement between the parties. The only agreement that one can say with certainty the parties would have agreed to is one that they actually entered into. The insistence in the case law that the blue-pencil test derives its validity from refusing to change or add words to the provisions to the contract is unconvincing. It is doubtful, for example, that the lenders in cases such as *Thomson*, *supra*, or *Mira Design Co*., *supra*, would have entered into the agreements at issue had they been aware ex ante that they would only be entitled to the return of the principal advanced. The change effected by the blue-pencil technique will often fundamentally alter the consideration associated with the bargain and do violence to the intention of the parties. Indeed, in many cases, the application of the blue-pencil approach will provide for an interest-free loan where the parties demonstrated in the agreement a clear intention to charge and pay considerable interest.
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> …I am in complete agreement with the conclusion that when a court employs the blue-pencil test, it is making a new agreement for the parties. Indeed, all forms of severance alter the terms of the original agreement.

6. However, Arbour J. recognized that the blue-pencil approach would not always result in an agreement consistent with the intention of the parties. The concept of notional severance was therefore applied to rectify this deficiency at paras. 32, 33, 38 and 40:

> The preferred severance technique is the one that, in light of the particular contractual context involved, would most appropriately cure the illegality while remaining otherwise as close as possible to the intentions of the parties expressed in the agreement. The blue-pencil technique may not necessarily achieve that result….
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> The blue-pencil test is imperfect because it involves mechanically removing illegal provisions from a contract, the effects of which are apt to be somewhat arbitrary. The results may be arbitrary in the sense that they will be dependent upon accidents of drafting and the form of expression of the agreement, rather than the substance of the bargain or the consideration involved…. Although the results obtained from the blue-pencil approach will in many cases be sensible and may often be desirable, due to its artificiality, the application of the blue-pencil approach will sometimes be inappropriate….
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> [T]he results associated with the application of the blue-pencil approach are overly dependent upon the form of the contract, rather than its substance…. Results this erratic and sensitive to the form of contractual expression are

> undesirable, and can be avoided through the use of notional severance in cases where considerations flowing from the broad contractual context favour the lender….
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> Thus, the appropriate approach is to vest the greatest possible amount of remedial discretion in judges and courts of first instance. The spectrum of available remedies runs from a court holding contraction in violation of s. 347 void *ab initio*, in the most egregious and abusive cases, according to the criteria identified in *Thomson*, *supra*, to notional severance. In the determination of where along the spectrum a particular contract lies, the considerations identified in *Thomson* by Blair J.A. should be referred to and analysed carefully.

7. Arbour J. further stated at para. 41 that "…the maximum level of remedial flexibility should be vested in judges and available for application by them subject to a careful analysis of the factors identified in *Thomson*."

8. Courts have since considered *Transport North America* and the doctrine of notional severance. In *ACS Public Sector Solutions Inc. v. Courthouse Technologies Ltd*. (2005), 48 B.C.L.R. (4th) 328 (B.C. C.A.), Donald J.A. of the British Columbia Court of Appeal stated at para. 58-59:

> …[T]he Supreme Court of Canada reversed the Ontario Court of Appeal, which blue pencilled the agreement to bring the rate of interest well under 60 per cent, and restore the trial judge's notional severance, which simply read down the agreement to 60 per cent.
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> In my view, the spectrum theory endorsed by the Supreme Court of Canada applies to any illegal contract provision, whether by common law or statute. The blue-pencil approach finds itself on the spectrum and is an available remedy in appropriate circumstances. So the law has travelled some distance from the all-or-nothing proposition advanced by the appellants. In my judgment, this was an appropriate case for severance and the trial judge applied the blue-pencil remedy appropriately. Contrary to the submission of the appellants, he was not obliged to strike down the whole of the restrictive covenant because of overbreadth in part of it.

9. In *KRG Insurance Brokers (Western) Inc. v. Shafron*, (2007) BCCA 79 (B.C. C.A.), the British Columbia Court of Appeal further applied *Transport North America* and *ACS* to deal with restrictive covenants in an employment context. At para. 53, Chiasson J.A. stated: "This theory is helpful in this case where the parties' words of geographic limitation have no easily ascertainable precise meaning, but express a clear intention to protect some spatial area from competition."

10. Chiasson J.A. stated at para 54 that the Supreme Court of Canada

> has recognized that all forms of severance alter the terms of the original agreement and has accepted an approach which reads down contractual provisions to cure illegality, as long as the legally legitimate intentions of the parties reasonably are respected.

11. In *KRG*, the parties' agreement as to the geographic reach of the restrictive covenant dealt with the "Metropolitan City of Vancouver." The court found difficulty in properly defining "metropolitan" and found that striking the term metropolitan, the blue-pencil approach, would distort the parties' intention.

12. At para. 61, Chiasson J.A. stated:

> In my view of the clear direction of the Supreme Court of Canada that it is permissible to use notional severance to attempt to give effect to the substance of an agreement and to avoid having that substance subverted by an unfortunate choice of language, I would construe "Metropolitan City of Vancouver" to prevent Mr. Shafron from competing in the City of Vancouver and municipalities directly contiguous to it.

13. To arrive at this decision, Chiasson J.A. applied the four factors Arbour J. stated should be considered from *Thomson*:

(1) would the purpose of the law's reluctance to enforce covenants in restraint of trade in the employment context be subverted?

(2) did the parties enter into the agreement for an illegal purpose or with an evil intention?

(3) what is the relative bargaining position of the parties? and

(4) is there a potential for an unjustified windfall?

14. By adopting notional severance in *Transport North America*, Arbour J. gave judges another tool in interpreting a restrictive covenant. However, it was unclear whether that tool would also become a requirement, whether using notional severance was merely optional or "permissible" as stated at para. 61 by Chiasson J.A. in *KRG*, or whether the law of severance would be re-visited by the Supreme Court of Canada. The question, after *KRG*, was whether judges were now required to attempt to read down a clause if the blue-penciling approach is inapplicable?

15. In *Atlantic Business Interiors Ltd. v. Hipson*, 2005 NSCA 16, 38 C.C.E.L. (3d) 1 (N.S. C.A.), the Nova Scotia Court of Appeal upheld the trial judge's decision to find that a non-competition clause was unenforceable. At para. 43, Freeman J.A. stated

> In my view [the trial judge] did not err in applying the J.G. Collins Insurance Agencies principles in finding the restrictive covenant to be unenforceable, nor

> in refusing to sever it or write it down. I would uphold his conclusion. [Emphasis added].

16. Also, the Court of Appeal of Alberta in *Globex Foreign Exchange Corporation v. Kelcher*, 2005 ABCA 419 (Alta. C.A.) found that a non-competition clause was overbroad and unenforceable and refused to use notional severance to "read down" the non-competition clause into being a non-solicitation clause. McFayden J.A. stated at para. 49:

> Employers should not be permitted to draft unreasonably broad restrictive covenants with the expectation that, should the matter ever come to trial, the court will simply re-write the clause so as to make it enforceable.

17. Frankel J. declined to read down a restrictive covenant as was done in *KRG* in *Jordan v. Pacific Sign Group Inc*., 2007 BCSC 574 at para. 32 (B.C. S.C.):

> I should indicate that, having regard to *KRG Insurance Brokers (Western) Inc. v. Shafron*, I have considered, but rejected, the concept of "reading down" as a means of giving some effect to the restrictive covenant. Pacific Sign clearly intended to prevent Mr. Jordan from competing with it in any way. To now attempt to impose more moderate restrictions would require me to rewrite, as opposed to interpret, the contract. This I cannot do.

18. Frankel J. enforced portions of a restrictive covenant regarding confidentiality but found non-competition and non-solicitation clauses unenforceable; Frankel J. essentially used the "blue-pencil approach" without stating as much. Further, Frankel J. may have been assisted by a severance clause contained in the restrictive covenant:

> 5.7 Each provision of this section 5 constitutes a separate and distinct covenant and is severable from all other provisions of this part, and without limitation, each activity restrained in subsection 5.1, the geographical area specified in subsection 5.3 and the period of time contained in subsection 5.4, constitutes a separate and distinct covenant severable from all other provisions of the Agreement. If any restraint on the activities, time period or geographical area is considered by a Court of competent jurisdiction to be unreasonable or uncertain, that Court will have jurisdiction to limit that restraint, or substitute for that restraint the broadest restraint that would not be unreasonable or uncertain.
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> 5.8 If any provisions of this section 5 is determined to be illegal, void and unenforceable in whole ore in part, it will not affect or impair the enforceability or validity of the remainder of that provision, if any, or any other provision or part thereof in this section 5.

19. Nordheimer J. in *Jet Print Inc. v. Cohen*, [1999] O.J. No. 2864 (Ont. S.C.J.) expressed difficulty in severing an offending part of a restrictive covenant when the employment contract did not contain a severability clause at para. 15:

> Further, there is no provision in the employment contracts, which makes the restrictive covenants severable. There is, therefore, no foundation for carving out, or cutting back, the restrictive covenants over which I have such concerns. The restrictive covenants therefore stand or fall as a whole and in my view there is a serious issue as to whether they can stand.

20. Generally, the case law after *KRG* indicated that courts would use the blue-pencil approach to remove offending terms and use notional severance to interpret ambiguous terms. Courts may be more inclined to sever a term if there is a severance clause in the restrictive covenant. However, courts showed a reluctance to use notional severance to replace a non-competition clause with a non-solicitation clause; notional severance has been used to interpret a restraint on trade, not to limit the restraint to an enforceable level.

21. Moreover, *KRG* was subsequently appealed to and unanimously overturned by the Supreme Court of Canada, in *Shafron v. KRG Insurance Brokers (Western) Inc.* (2009 SCC 6). In doing so, the Court held that "notional severance has no place in the construction of restrictive covenants in employment contracts" (at para. 37), and 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 purport of the restrictive covenant" (at para. 36).

22. As noted above, the geographical scope of the restrictive covenant was the "Metropolitan City of Vancouver", which Chiasson J.A. 'construed' to prevent Mr. Shafron from competing "in the City of Vancouver and municipalities directly contiguous to it" (para. 61).

23. However, as noted in the reasons of the Supreme Court of Canada (paras. 44-5):

> The trial judge found that there was no legal or judicial definition of the term "Metropolitan City of Vancouver". In finding that the spatial area covered by the restrictive covenant was not clear and certain, the trial judge referred to the evidence of the principal of KRG Western. At para. 56 of his reasons, he wrote:
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>> Mr. Meier's [principal of KRG Western] cross-examination at this trial was revealing as to what the parties had in mind when the phrase was used. At one point he testified that the phrase "means different things to different people". As his evidence progressed he thought that what was intended was the Greater Vancouver Regional District but "not Lion's Bay". At another point he indicated that it meant "Vancouver and suburbs" and finally he defined it on a population base indicating he thought it included "1.4 million people". During the course of his evidence he clearly indicated his belief that it was not limited to the City of Vancouver.
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> On the basis of this and other evidence, the trial judge found that the language of the restrictive covenant was neither clear nor certain and for this and other reasons dismissed the claim of KRG Western against Shafron.

> The Court of Appeal agreed that the term "Metropolitan City of Vancouver" was ambiguous. At para. 59, Chiasson J.A. wrote:
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>> There is no fixed, recognized meaning for the phrase "Metropolitan City of Vancouver". Various suggested meanings were provided at trial and in this Court. They served merely to reinforce the ambiguity of the phrase.
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> However, the Court of Appeal was satisfied that "there is no doubt that the parties intended to prevent Mr. Shafron from competing in the City of Vancouver and an area beyond the City" (para. 80). It then determined that what "likely was in the reasonable contemplation of the parties when they made their agreement" (para. 63) was "the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby" (para. 61). In construing the ambiguous term "Metropolitan City of Vancouver" in the way it did, the Court of Appeal said that it relied on the doctrine of notional severance to resolve the ambiguity.

24. Imagine Mr. Shafron's surprise - even shock - to be told by an appellate court of such undoubted intention on his part, given both such unclear and uncertain evidence by his former boss, and the resultant findings of fact by the Trial Judge.

<u>Notional Severance</u>

25. Writing for the Court, Rothstein, S.C.J. noted that "[n]otional severance involves reading down an illegal provision" and stated that "[i]t is apparent that Arbour J. would not have applied the doctrine of notional severance where there was no bright-line test for illegality" (citing *Globex*, at para. 46).

26. Why not? As pointed out in Mr. Shafron's factum, "the very problem presented by [*KRG*]" was directly addressed both by the Supreme Court of Canada, in *Transport*, and by the Alberta Court of Appeal in *Globex*. The Court in *Globex* stated as follows (paras. 46-7):

> Justice Arbour, for the majority of the court, found that notional severance is available as a matter of law as a remedy in cases arising under s. 347: para. 5. In such cases, there is a clear statutory "bright line" differentiating legal contractual provisions from illegal. It can be a straightforward matter, in cases where the evidence shows the parties did not intend to breach the statute, to reduce the interest provisions to the statutory maximum. A difficulty with attempting to apply the doctrine to restrictive covenants is that there is no clearly discernible legal standard for the courts to apply. If such covenants could be re-written to meet a standard of "reasonableness" as determined by the court, there would be no certainty of contract until the matter was decided at trial.
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> Arbour J. recognized this distinction. At para. 34 she referred to contracts in

restraint of trade as an example of a provision that does not involve the application of a “bright line” test:

> Section 347 of the *Code* invites difficulties with arbitrariness by imposing a bright line of 60 percent as demarcating legal interest from illegal interest. This legislatively mandated bright line distinguishes s. 347 cases from those involving provisions, for example, in restraint of trade, where there is no bright line. [emphasis in original]

27. Clearly, Justice Arbour made the latter observation with the dissenting reasons of Justice Bastarache in mind. After considering the restrictive covenant decision of the British Columbia Court of Appeal in *Canadian American Financial Corp. v. King* (1989), 60 D.L.R. (4th) 293, Bastarache S.C.J. stated (at paras. 60 & 62):

> Lambert, J.A. concluded that the authorities were clear that courts may not make contracts for parties that they have not made themselves. In his opinion, substituting the words “British Columbia and Alberta” for “Canada and Bermuda” would have rendered the term enforceable, but that was something for the parties, not the court, to do. Under the new approach, would judges be permitted to make such substitutions in order to render the contract reasonable?”
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> ...Furthermore, Lambert, J.A. held that a clause, where one alternative encompasses another would be, in his opinion, void for uncertainty and should not be made valid by severance. For example, a contract including a covenant not to compete: (1) in Ottawa, and (2) in the rest of Ontario, might be valid as Ottawa, but overbroad and therefore wholly invalid, as to Ontario... [U]nder the approach adopted by my colleague, could a court rewrite the second clause to read, for example, “in the rest of northeastern Ontario”, so that it no longer constitutes an illegal restraint of trade? [emphasis in original]

28. Accordingly, Justice Rothstein held as follows in *Shafron* (at paras. 37-41):

> I am also of the view that notional severance has no place in the construction of restrictive covenants in employment contracts. In my opinion, there are at least two reasons why it would be inappropriate to extend the doctrine of notional severance to the case of restrictive covenants in employment contracts.
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> First, there is no bright-line test for reasonableness. In the case of a contract that provides for an illegal rate of interest, for example, notional severance has been used to bring the rate down to the legal rate of 60 percent. In *Transport*,

the evidence was that the parties did not intend to enter into an illegal contract, and what must be done to make the contract legal was quite clear. The Court inferred that the parties' original common intention was to charge and pay the highest legal interest rate and notional severance was applied to read down the rate to the highest legal rate.

In the case of an unreasonable restrictive covenant, while the parties may not have had the common intention that the covenant be unreasonable, there is no objective bright-line rule that can be applied in all cases to render the covenant reasonable. Applying notional severance in these circumstances simply amounts to the court rewriting the covenant in a manner that it subjectively considers reasonable in each individual case. Such an approach creates uncertainty as to what may be found to be reasonable in any specific case.

Second, applying the doctrine of notional severance runs into the problem identified by Lord Moulton in *Mason* [*v. Provident Clothing and Supply Co.*, [1913] A.C. 724]. It invites the employer to impose an unreasonable restrictive covenant on the employee with the only sanction being that if the covenant is found to be unreasonable, the court will still enforce it to the extent of what might validly have been agreed to.

Not only would the use of notional severance change the terms of the covenant from the parties' initial agreement to what the court thinks they should have agreed to, it would also change the risks assumed by the parties. The restrictive covenant is sought by the employer. The obligation is on the employee. Having regard to the generally accepted imbalance of power between employers and employees, to introduce the doctrine of notional severance to read down an unreasonable restrictive covenant to what is reasonable provides no inducement to an employer to ensure the reasonableness of the covenant and inappropriately increases the risk that the employee will be forced to abide by an unreasonable covenant. [emphasis added]

29. The latter comments echoed the well-known statement of Lord Moulton in *Mason v. Provident* (cited in *Shafron*, at para. 33):

> It would in my opinion be pessimi exempli if, when an employer had exacted a covenant deliberately framed in unreasonably wide terms, the Courts were to come to his assistance and, by applying their ingenuity and knowledge of the law, carve out of this void covenant the maximum of what he might validly have required. It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is usually at a great disadvantage, in view of the longer purse of his master.

Blue Pencil Severance

30. The *Shafron* court further held that (at paras. 36 & 48-50):

> [T]he approach of Lord Moulton in *Mason* is the appropriate view of the law rather... [B]lue-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 purport 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.
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> In the alternative, KRG Western submitted... that, if this Court is unwilling to uphold the decision of the Court of Appeal which held that "Metropolitan City of Vancouver" should be read to include the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby that this Court should apply blue-pencil severance and remove the word "Metropolitan". In my view, blue-pencil severance does not apply here.
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> As I have stated, blue-pencil severance is to be applied narrowly, and only in particular circumstances. In *Canadian American Financial Corp.(Canada) Ltd. v. King* (1989), 60 D.L.R. (4th) 293 (B.C.C.A.), Lambert J.A. stated, at pp. 305-306, that
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> > the courts will only [apply blue pencil severance to] sever the covenant and expunge a part of it if the obligation that remains can fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agreed to it without varying any other terms of the contract or otherwise changing the bargain. ... It is in that context that reference is made in the cases severing and expunging merely trivial or technical parts of an invalid covenant, which are not part of the main purport of the clause, in order to make it valid.
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> Removal of the word "Metropolitan" would leave behind only "City of Vancouver"... However, there is no evidence that the parties would have "unquestionably" agreed to remove the word "Metropolitan" "without varying any other terms of the contract or otherwise changing the bargain". Blue-pencil severance is therefore not applicable in this case.

31. The Court did not just expressly accept Lord Moulton's approach as appropriate. It also expressly rejected the approach taken in other decisions, that:

> [S]everance might be applied if the severed parts are independent of one another or can be severed without the severance affecting the meaning of the part remaining. See, for example (the examples cited were *T. S. Taylor Machinery Co. v. Biggar* (1968), 2 D.L.R. (3d) 281 (Man. C.A.), at p. 290, *Putsman v. Taylor*, [1927] 1 K.B. 637 (Div. Ct.), at pp. 639-40, and *T. Lucas & Co. v. Mitchell*, [1974] Ch. 129 (C.A.), at p. 135.

32. Indeed, the Supreme Court of Canada did not even accept "that what the Court of Appeal did constituted notional severance", stating that (at para. 47):

> [I]n *Transport*, notional severance was used to read down an illegal provision in a contract to render it legal. That is not what the Court of Appeal purported to do in this case. It was in fact 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 (at paras. 59 and 63). As stated earlier, notional severance does not permit a court to rewrite a restrictive covenant in an employment contract in order to reflect its own view of what the parties' consensus *ad idem* might have been or what the court thinks is reasonable in the circumstances non-solicitation clause] provision prohibits a departing employee from soliciting the customers of his or her previous employer. [emphasis added]

As the relevant heading of the *Shafron* reasons states: "Severance Cannot Be Invoked to Resolve [an] Ambiguity".

The hypothetical

33. To go back to the hypothetical situation at the beginning of this paper, the geographical restriction of south-western Ontario may be seen as too vague and the blue-pencil approach, striking out south-western Ontario, would not clarify the ambiguity. However, applying notional severance from *Transport North America*, the Court of Appeal decision in *KRG* and *Thomson* would allow a court to define the geographic boundary without voiding the restrictive covenant altogether. Further, if the restrictive covenant has a severance clause, as in *Jordan v. Pacific Signs*, a court may be more likely to find non-offensive clauses enforceable. However, the Supreme Court of Canada's decision in *Shafron* has now put paid to notional severance, and severely limited the use of 'blue pencil severance, regarding restrictive covenants in employment contracts.

Part 2: The best method to protect your interests

Non-competition and non-solicitation clauses

34. Before discussing the specifics of the different types of restrictive covenants, some

background is required. Generally speaking, a restrictive covenant is unenforceable as being contrary to public policy. It will only be enforced if it is necessary to protect the legitimate proprietary interest of the proponent. It will fail if it goes beyond what is necessary.

35. One of the leading cases regarding restrictive covenants in Canada is *J.G. Collins Insurance Agencies Ltd. v. Elsley*, [1978] 2 S.C.R. 916 (S.C.C.). Dickson J. stated at 923 that a restrictive covenant is enforceable "only if it is reasonable between the parties and with reference to public interest."

36. In *Lyons v. Multari* (2000), 50 O.R. (3d) 526 (Ont. C.A.), Macpherson J.A. provided some useful definitions of the different types of restrictive covenants at paras. 30-31:

> [A non-solicitation clause] provision prohibits a departing employee from soliciting the customers of his or her previous employer.
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> The non-competition clause is more drastic weapon in an employer's arsenal. Its focus is much broader than an attempt to protect the employer's client or customer base; it extends to an attempt to keep the former employee out of the business. Usually, non-competition clauses are limited in terms of space and time.

37. The term "solicit" was considered by the British Columbia Court of Appeal in *Dr. P. Andreou v. McCaig*, 2007 BCCA. 159 (B.C. C.A.). Huddart J.A. found that "solicit" meant more than a general advertisement in a newspaper announcing the opening of a new business (see also *Jordan v. Pacific Sign Group Inc.*, 2007 BCSC 574 at para. 23 (B.C.S.C.)).

38. In the recent case of *H.L. Staebler Company Limited v. Allan*, 2008 ONCA 576 (Ont. C.A.), the Court of Appeal for Ontario considered non-competition and non-solicitation clauses. Gillese J.A. at para. 36 set out the *Elsley* test:

> Reasonableness is the mechanism by which a court decides whether a covenant is "overly broad" or is only that which is reasonably required for the employer's protection. But how is a court to determine whether any given restrictive covenant is "reasonable"? *Elsley* offers a framework for making such a determination. The starting point is "an overall assessment of the clause, the agreement within which it is found, and all of the surrounding circumstances". Thereafter, three factors must be considered. First, did the employer have a proprietary interest entitled to protection? Second, are the temporal or spatial features of the covenant too broad? And, third, is the covenant unenforceable as being against competition generally, and not limited to proscribing solicitation of clients of the former employer?

39. Generally, a non-competition clause will only be enforceable, as stated in *Elsley*, "in exceptional cases." As stated by Gillese J.A. at para. 42 in *Staebler*:

> In short, a general principle flowing from *Elsley* and reiterated in *Lyons* is that a non-solicitation clause – suitably restrained in temporal and spatial terms – is more likely to represent a reasonable balance of the competing interests than is a non-competition clause. An appropriately limited non-solicitation clause offers protection for an employer without unduly compromising a person's ability to work in his or her chosen field. A non-competition clause, on the other hand, is enforceable only in exceptional circumstances.

40. In *Altam Holdings Ltd. v. Lazette*, 2009 ABQB 458, the plaintiff was a contractor which provided rig moving supervision services to oil company customers. Work for Conoco accounted for approximately 90% of Altam Holdings' profits. When Leonard Lazette left its employment, Altam sought to enjoin him from competing against it, soliciting its customers and using its confidential information, pursuant to three sub-clauses of Article 9 in his employment contract.

41. In lengthy reasons, the Alberta Court of Queens Bench refused to grant an injunction. Justice Lee considered two main issues. First, like the trial decsion in *Shafron*, whether a non-competition clause was necessary, or a simple non-solicitation clause was sufficient to protect Altam's interests. Second, whether the non-solicitation clause could be enforced if the non-competition clause was not.

42. The latter issue involved the blue pencil rule, and the Supreme Court of Canada's decision in *Shafron*. The Court held as follows (paras. 28-9):

> …While it was the practice of some Courts to strike out portions of these restrictive covenants and to leave other portions standing with a theoretical "blue pencil", such practice must be revisited in light of the Supreme Court's more recent decision in ***Shafron***. That case at paragraphs 33 to 36 suggests that the blue pencil is not appropriately used to save a restrictive covenant unless the modification sought is "clearly severable, trivial and not part of the main purport of the restrictive covenant".
>
> In this case, <u>it is clear that there can be no modification to remove only parts of Article 9. The main purport is to prevent Mr. Lazette from working in rig moving. In particular, Articles 9.06 through 9.08 operate as a whole</u>, with common self-contained definitions and a common objective. For instance, the "non-solicitation" clauses at 9.08 contain in 9.08.3 a prohibition against soliciting work from "any contacts of [Altam] with any such Company [for whom Altam has done work], in any manner or for any purpose whatsoever". Such a clause is really a non-competition clause that prevents Mr. Lazette from seeking any work from the individuals that he might know at any companies that Altam has worked for, for any purpose. Given Altam's broad reading of these terms, such prohibition could presumably apply if and when such individual(s) left Conoco and went elsewhere. Conversely, such a prohibition could also apply should Mr. Lazette solicit work from someone working elsewhere who goes on to Conoco, or

another Altam client and becomes an Altam contact. No part of the restrictions in 9.06-9.08 are "trivial"; if any of the clause is struck, it must all be struck. [emphasis added]

43. So, severance is not limited to geographical and temporal restrictions in restrictive covenants. It also extends to the nature of the activities prohibited. Likewise, the limitation on and prohibition against blue pencil and notional severance which the Supreme Court of Canada has imposed in Shafron, apply to all three of such factors in restrictive covenants.

The factors courts will consider in determining whether a clause is "reasonable"

44. Any assessment of the restrictive covenant, as set out in *Elsley*, must be done taking into account the "surrounding circumstances." To do that, the court must examine "the nature of the employer's business and the character of the employee's position" according to Gillese J.A. at para. 47 of *Staebler* and the Court of Appeal for Ontario in *Ash Temple Limited v. Croney* (2000), 46 O.R. (3d) 561 at para. 33 (Ont. C.A.).x

45. *Staebler* dealt with two former insurance salespeople who had signed restrictive covenants which stipulated that for two years after the termination of their employment, they were prohibited from conducting "business with any clients or customers of H.L. Staebler Company Limited that were handled or serviced by you." A liquidated damages clause was also included in the employment contracts. As soon as the employees stopped working for Staebler, they began working for a competitor, Stevenson & Hunt Insurance Brokers (KWC) Limited ("Stevenson & Hunt").

46. Staebler sued the employees for breaching the restrictive covenant and named Stevenson & Hunt as defendants. Within two weeks of the employees switching to Stevenson & Hunt, Staebler obtained an injunction which was effective for two years preventing the employees and Stevenson & Hunt from soliciting Staebler's customers. However, by that time, approximately 118 customers had switched from Staebler to Stevenson & Hunt.

47. The trial lasted 13 days. Taylor J. found that the restrictive covenant and liquidated damages clauses were enforceable and ordered the employees and Stevenson & Hunt to pay Staebler approximately $2 million in damages.

48. The Court of Appeal for Ontario allowed the appeal and found that the restrictive covenant was unenforceable. The restrictive covenant read:

> In the event of termination of your employment with the Company, you undertake that you will not, for a period of 2 consecutive years following said termination, conduct business with any clients or customers of H.L. Staebler Company Limited that were handled or serviced by you at the date of your termination.

49. Staebler also had used with other employees a different restrictive covenant which allowed an employee to solicit and conduct business with former clients as long as the employee did not operate within a 50 mile radius of the Waterloo region for two years.

50. Taylor J. referred to the restrictive covenant as a "hybrid" clause, a combination of a non-solicitation and non-competition clause. Gillese J.A. disagreed stating at para. 46:

> On a plain reading of the Restrictive Covenant, it is a non-competition clause. It does not purport to merely restrain the Employees from soliciting the clients and customers they had served when they worked at Staebler, it prohibits the Employees from "conduct[ing] business" with any such clients.

51. Taking into account the "surrounding circumstances" of the case, Gillese J.A. found that:

> [A]n employment contract with some type of restrictive covenant was warranted. They do not, on their own, provide evidence of "exceptional" circumstances that would justify a non-competition clause.

52. To determine the reasonableness of the limits of the restrictive covenant, Gillese J.A. considered the three factors from *Elsley*. First, there was no dispute that Staebler had a proprietary interest that it was entitled to protect. Second, the restrictive covenant prohibited the employees from doing business anywhere, not just within the 50 mile radius to which other employees were bound. Further, there was no limit on the restriction as to the type of work the employees could perform; according to the restrictive covenant, the employees were prohibited from working for their former customers even if they did so in a totally different capacity. Gillese J.A. found it unnecessary to deal with the third factor of whether the restrictive covenant was against competition generally having found at para. 53:

> The absence of a geographical limit combined with the blanket prohibition on conducting business renders the Restrictive Covenant "overbroad" and unenforceable. It unreasonably restricts the Employees' economic interests and goes beyond that which is reasonably necessary to protect Staebler's proprietary interest.

53. It is of note in *Staebler* that the Court of Appeal for Ontario did not discuss attempting to use notional severance to read down an offending clause as the Court of Appeal for British Columbia did in *KRG*. In *Staebler*, Gillese J.A. found that the non-competition clause was unenforceable given the defendant's position within his former company, but did not then attempt to read down the clause to a non-solicitation clause. However, *Staebler* and *KRG* are not necessarily inconsistent. In *KRG*, Chiasson J.A. used notional severance to read down or interpret a geographical definition which was part of the restrictive covenant; in *Staebler*, the restrictive covenant did not express with sufficient clarity whether it was a non-competition or non-solicitation clause and likewise did not sufficiently clarify the type of prohibited work or the geographical boundaries. It would have been difficult in these circumstances to read down a restrictive covenant which was overbroad in several respects, essentially re-writing it, as

opposed to interpreting a definition in a clause consistent with the intention of the parties; *KRG* dealt with vagueness in a definition, *Staebler* with an overbroad covenant.

54. As with other factors, a reasonable temporal restriction of a restrictive covenant takes into account the employee's role within the company. In *KRG*, the Court of Appeal for British Columbia enforced a three-year temporal restriction on a former insurance brokerage company owner who had a 40-year relationship with his former employer's customers.

55. In *KRG*, Chiasson J.A. of the Court of Appeal for British Columbia stated at para. 80 that:

> [T]he restrictive covenant in this case is reasonable between the parties in term of its temporal length, the spatial area covered, the nature of the activities prohibited and its overall fairness. The terms of the covenant are clear, certain and not vague…. The restraint is reasonable in terms of the public interest considering the nature of the business and the availability of general insurance agencies to the public in the area covered by the restraint.

56. The Supreme Court of Canada, however, restored the trial judgment in *Shafron*, that "the restrictive covenant was unreasonable (para. 52)." Parrett, J., of the British Columbia Supreme Court, had held that (at paras. 52):

> In my view, a three year restrictive covenant in the circumstances of the case at bar far exceeds what is reasonably necessary to protect the plaintiff's reasonable interests.

57. The Trial Judge also held that (at para. 60 and para. 4 of the summary at p. 35):

> [T]he restrictive covenant... imposes a total prohibition [on competition] when less restrictive measures would be more than adequate." (para. 4 of summary at p. 35)
>
> and
>
> The plaintiff's legitimate interests could have been protected by a non-solicitation clause.

58. In *KRG*, both the Trial Judge and the Court of Appeal adopted the following helpful summary of factors from *Arum Ceramic Dental Laboratories v. Hwang*, [1998] B.C.J. No. 190 (B.C. S.C.) to be considered in determining whether a restrictive covenant is enforceable:

(a) the restraint protect a legitimate proprietary interest of the employer;

(b) the restraint is reasonable between the parties in terms of:

(i) temporal length;

(ii) spatial area covered;

(iii) nature of activities prohibited; and

(iv) overall fairness;

(c) the terms of the restraint are clear, certain and not vague; and

(d) the restraint is reasonable in terms of the public interest with the onus on the party seeking to strike out the restraint.

59. *Mick v. Boulder City Climbing School Inc*. (2007) C.L.L.C. 210-048 (Ont. S.C.J.) dealt with a former employee, Mick, of a company which provided rock climbing programs. The employment contract contained a restrictive covenant for a period of two years (twice the length of the contact) and prohibited Mick from being "directly or indirectly engaged in a company or firm which is a direct competitor to the employer in the Province of Ontario," prohibited him from being employed by or operating a similar business in the Province of Ontario, and prohibited him from soliciting anyone who was ever a customer of the company. Metivier R.S.J. applied the factors in *Elsley* and *Lyons* and found that the restrictive covenant was unenforceable as being too broad and not reasonable in the circumstances. Specifically, Metivier R.S.J. found that the length of the restriction was too long considering the length of the contract and the prohibition against all competition in a similar business "far exceeds the mere proscribing of solicitation of clients of the former employer."

60. In *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc*., 2007 BCCA 22 (B.C.C.A) leave to appeal allowed, [2007] S.C.C.A. No. 121, the British Columbia Court of Appeal analyzed the situation in the brokerage industry and allowed an appeal in an action against a former branch manager and 9 advisors (of 11 total) of an investment firm who resigned and began working for a competitor. Before resigning, the former employees copied or removed almost all client records which were later returned. Homes J. allowed the action in part against the former employees for, *inter alia*, breach of contract and found that the former employees breached their duty to not compete unfairly against the plaintiff. Homes J. also found as a fact that it was common industry practice that employees would take clients with them to their new firms.

61. In a majority decision, the British Columbia Court of Appeal found that former employees do not have a duty to refrain from competing unfairly with a former employer. A key factor in the decision of Southin J.A. was that the plaintiff was a sophisticated business where advisors moved often and where clients typically moved with their advisors. RBC chose to not have its employees sign non-competition or non-solicitation clauses. Leave to appeal to the Supreme Court was granted. The case was argued and reasons are expected shortly. Hopefully the Supreme Court will provide some further guidance on the proper scope of restrictive covenants in the investment advisor industry. If the British Columbia Court of Appeal

decision stands it will have significant repercussions in that industry.

62. In *Sherwood Dash Inc. v. Woodview Products Inc.*, Perell J. discussed his difficulty with the spatial features of a non-competition clause at para. 68:

> The spatial feature of the restrictive covenant is particularly problematic. There is no spatial limitation, and Messrs. Nguyen and Burton are essentially disqualified from working in a field in which they have acquired skills and knowledge. The information and training provided by an employer to an employee that do not involve trade secrets are beyond the reach of a restrictive covenant: *Maguire v. Northland Drug*, supra; Sir *W.C. Leng & Co. v. Andrews* (1908), [1909] 1 Ch. 763 (Eng. C.A.). In my view, the non-competition clause in the immediate case goes too far in protecting the proprietary interests of Sherwood and is not reasonable as between the parties nor is it reasonable in terms of the public interest.

63. Overall, in determining whether a restrictive covenant is reasonable, courts will consider the range of factors adopted in *KRG*. However, recent case law shows that these factors are only the starting point and that courts have a wide discretion under these factors in determining whether a restrictive covenant is reasonable taking into account all the surrounding circumstances.

64. In *Shafron*, the Supreme Court of Canada based its decision on the often over-looked requirement (c) in the *Aurum* list. Namely, that "the terms of the restraint are clear, certain and not vague". It is suggested that this is the logical starting point for any analysis of whether a restrictive covenant a contract of employment is enforceable.

65. That is, courts and counsel alike confront two separate and distinct issues in these cases. Firstly, what the words of a contract mean and, secondly, whether it would be reasonable to enforce them. The first step is to determine whether the restrictive covenant in question even constitutes a legally binding agreement. If the answer to that question is 'yes', then the second step is to determine whether the scope of the covenant is reasonable, and therefore enforceable, on equitable, public policy grounds.

66. It is only at the latter stage of the analysis that severance may be invoked. Hence the Supreme Court of Canada's above-noted observation that what the Court of Appeal for British Columbia did did not constitute notional severance. As pointed out in Mr. Shafron's factum,

> **1. With respect, [the Court of Appeal's] analysis confuses and conflates two separate and distinct issues... As is plain on all of the authorities referred to by the Courts, and cited herein, the purpose of severance – whether notional or 'blue pencil' – is to reduce or 'sever' the unreasonable scope of an otherwise clear, certain, and binding contractual term. Severance is the second step in the analysis. It is <u>not</u> to '<u>construe</u>' the scope of (for example) a restrictive covenant. That is the first step... Severance involves reducing or 'reading**

> **down' the covenant, if and when appropriate, to a narrower, reasonable and therefore enforceable scope... (emphasis in original)**

67. As Rothstein, S.C.J. stated (at paras. 43-6):

> Normally, the reasonableness of a restrictive covenant is determined by considering the extent of the activity sought to be prohibited and the extent of the temporal and spatial scope of the prohibition. This case is different because of the added issue of ambiguity. As indicated, a restrictive covenant is *prima facie* unenforceable unless it is shown to be reasonable. However, if the covenant is ambiguous, in the sense that what is prohibited is not clear as to activity, time, or geography, it is not possible to demonstrate that it is reasonable. Thus, an ambiguous restrictive covenant is, by definition, *prima facie* unreasonable and unenforceable. Only if the ambiguity can be resolved is it then possible to determine whether the unambiguous restrictive covenant is reasonable.

Alternative or 'Russian Doll' Clauses

68. *Shafron* has been described by various commentators as a decision about ambiguity in the geographical scope of a restrictive covenant. The Supreme Court of Canada decision has also been characterized as "the end of restrictive covenants in Canada. It is suggested that the ramifications of the case are both broader than the former and narrower than the latter.

69. A careful consideration of the reasons in Shafron, together with prior decisions and one subsequent case in particular, reveals a particularly profound ramification. This concerns the enforceability of what are variously described as 'Russian doll', 'waterfall', 'ladder' or 'step' clauses, which stipulate alternative geographical and/or temporal scopes, usually in descending order. That ramification is demonstrated by, and cogently explained in *Bonazza v. Forensic Investigations Canada Inc.*, 2009 CanLII 32268 (ON S.C.).

70. *Bonazza* concerned an appeal from the decision of an arbitrator which held that a descending scope geographic covenant was enforceable, on the strength of *Community Credit Union Limited v. Ast*, [2007] A.J. No. 156 (Q.B.). The reasons of Aston J. include the following (paras. 6-8 and 10-15):

> The appellant contends that a descending scope geographic restriction is by its very nature ambiguous, and therefore always unenforceable, relying on the recent Supreme Court of Canada decision *Shafron v. KRG Insurance Brokers (Western) Inc.**[6]***. I agree. **In my opinion, *Shafron* sounds the death knell for descending scope restrictive covenants**.
>
> The arbitrator did not have the benefit of this case, as it was only released January 23, 2009. *Shafron* does not deal specifically with a descending scope

restrictive covenant,[7] but it is instructive on the issues of "blue-pencil severance" and "notional severance".

. . .

[8] Paragraph 2 of *Shafron* states that:

> Notional severance is not an appropriate mechanism to cure a defective restrictive covenant [in an employment contract]. As for blue-pencil severance, <u>it may only be resorted to in rare cases where the part being removed is trivial, and not part of the main purport of the restrictive covenant</u>."[8] (emphasis added)

. . .

At paragraph 43, the court goes on to state that:

> ...[I]f the covenant is ambiguous, in the sense that what is prohibited is not clear as to activity, time, or geography, it is not possible to demonstrate that it is reasonable. <u>Thus, an ambiguous restrictive covenant is, by definition, *prima facie* unreasonable and unenforceable. Only if the ambiguity can be resolved is it then possible to determine whether the unambiguous restrictive covenant is reasonable.</u> (emphasis added)

At paragraph 49, the Court cites with approval the judgment of Lambert J.A. in *Canadian American Financial Corp. (Canada) Limited v. King***[9]** at pages 305-306:

> The Courts will only apply blue-pencil severance to sever the covenant and expunge a part of it if the obligation that remains can fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agreed to it without varying any other terms of the contract or otherwise changing the bargain…it is in that context that reference is made in the cases severing and expunging merely trivial or technical parts of an invalid covenant, which are not part of the main purport of the clause, in order to make it valid.

In *Canadian American Financial*, at point 6, the British Columbia Court of Appeal, in obiter, stated:

> **It is no function of the courts to act as de facto arbitrators over clauses that are drawn as alternatives. If the covenant says that the employee will not compete in (a) Canada, (b) British Columbia, and (c) Vancouver…the courts ought not to use the "blue-pencil" rule to make an agreement for the parties that they have been unable to make for themselves. Such a clause, whose one alternative encompasses**

another, but on a wider scale, is, in my opinion, void for uncertainty and should not be made valid by severance. The only point on which the terms of the covenant are clear is that the covenant is to cover at least Vancouver…the parties could have said that. If they failed to do so, then they will risk losing the whole clause.

. . .

...*Shafron* establishes that, in the context of contractual obligations, consideration of "reasonableness" only arises after first finding there is no ambiguity. In light of *Shafron,* the arbitrator erred at law in resorting to severance as a means of resolving the ambiguity of the descending scope restrictive covenant, and unresolved ambiguity precluded any consideration of reasonableness. The restrictive covenant was unenforceable. [underlining in original; bold-face added]

71. This result is also consistent with *Globex* (cited in *Shafron*, at para. 46), as well as the dissent of Bastarache, S.C.J. (with which, as noted above, the majority reasons of Arbour, S.C.J. implicitly agreed on this point), in the very *Transport* case upon which the erroneous decision of the Court of Appeal for British Columbia in *KRG* was based. In *Globex*, the Court of Appeal for Alberta stated as follows (paras. 46-7):

After considering the restrictive covenant decision of the British Columbia Court of Appeal in *Canadian American Financial Corp. v. King* (1989), 60 D.L.R. (4th) 293, Bastarache J. stated (at paras. 60 & 62):

"...Furthermore, Lambert, J.A. held that a clause, where one alternative encompasses another would be, in his opinion, void for uncertainty and should not be made valid by severance. For example, a contract including a covenant not to compete: (1) in Ottawa, and (2) in the rest of Ontario, might be valid as Ottawa, but overbroad and therefore wholly invalid, as to Ontario. Including the two promises within the same contract renders the whole clause invalid" [emphasis in original]

72. Accordingly, the Supreme Court in *Shafron*, consistently with the prior decisions of the Courts of Appeal for British Columbia and Alberta, in *King* and *Globex*, has indeed "sound[ed] the death knell for descending scope restrictive covenants".

Confidentiality agreements

73. Connected with either a non-solicitation or non-competition clause, a confidentiality agreement is designed to protect a company's proprietary information. Even in cases where no confidentiality agreement is present, at common law a former employee is restricted from disclosing confidential information to third parties.

74. However, demonstrating that a former employee took confidential information is only the first step. A plaintiff must also show that the former used that confidential information to the detriment of the plaintiff. A breach of confidentiality is usually tied to another breach by a former employee, such as a breach of fiduciary duty or a duty to not solicit former clients.

75. In *Barton Insurance Brokers Ltd. v. Irwin*, 170 D.L.R. (4th) 69, 1999 BCCA 73 (B.C. C.A.), Hall J.A. discussed a former employee's duty of confidentiality regardless of whether the former employee has a contractual duty at paras. 17 and 18:

> …Absent any express contractual terms, the law has developed to provide that a former employee will not be at liberty to act in an unfair way to a former employer. Whether it be called a fiduciary duty, a duty of good faith or a duty of confidence, the theme running through this whole area of the law it that in appropriate circumstances, a former employee may be found to have breached an enforceable duty owed to a former employer and may be successfully sued for injunctive relied or for damages.
>
> Clearly, an employee has duties to a present employer not to divulge trade secrets or to work against the interests of his or her employment by the duty is not just limited to current employment. After leaving employment, an employee may be obligated not to pursue certain activities to the detriment of the former employer. For instance, it has been usually reckoned to be unfair conduct to permit a former employee to take with him or her customer lists to use for solicitation of business or divulge trade secrets or to seek to appropriate maturing business opportunities of the former employer. On the other hand, I suppose to avoid what might otherwise be a condition of almost involuntary servitude, it has long been held that an employee is free to compete for custom with a former employer. As usual in human affairs, the difficulty is in the details and it is often difficult to know where to draw the line.

76. In *Unified Freight Services Ltd. v. Therriault* (2006), 14 B.L.R. (4th) 285 (Alta. Q.B.), Erb J. found that a former supervisor in a freight company had a fiduciary duty and that the employee had breached a signed confidentiality agreement by taking and using confidential information. The employee had taken company documents while still employed and, on the day of termination, the employee turned over a 150 page master customer list he had at his home. Erb J. found that the employee's breach of the confidentiality agreement constituted an act of wilful insubordination.

77. In *Jones v. Klassen* (2006), 14 B.L.R. (4th) 212 (A.B.Q.B.), Acton J. found the following confidentiality clauses to be enforceable (and were also enforceable from a non-solicitation standpoint):

> 4. You shall keep and preserve all…account records, customer statements and files…during the course of your employment. In the event your employment with Edward Jones ends either through termination by Edward Jones or through

resignation by you, you will surrender to Edward Jones all of the above such property which shall be and remain the property of Edward Jones….

10. You shall at no time, while this agreement is in effect or thereafter (i) use any information acquired by you during the period of this agreement in a manner adverse to the interests of Edward Jones;….

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 Edward 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…. 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.

78. Acton J. set out the extent of the breach of confidentiality at para. 61: "[t]hat Mr. Klassen retained photocopies of the client and prospect lists is even more egregious; the information is the crucial proprietary property of Edward Jones, not the paper on which it is printed."

79. In both *Unified Freight* and *Jones v. Klassen*, the defendants knew before termination what the employer considered to be confidential. The fact that Unified and Edward Jones were so specific, and had employees sign the confidentiality agreements, made enforcement of the confidentiality agreements more palatable to the courts.

80. Generally, as with other compensatory damages, the damages for the improper use of confidential information are calculated by attempting to put the plaintiff in the position it would have been in "but for" the breach. In *Cadbury Schweppes Inc. v. FBI Foods Ltd*., [1999] 1 S.C.R. 142 (S.C.C.), Binnie J. stated at para. 73 "the Court is free to draw inferences from the evidence as to what would likely have happened 'but for' the breach." Further, McLachlin J.'s comments from *Canson Enterprises Ltd. v. Boughton & Co.,*[1991] 3 S.C.R. 534 at 556 (S.C.C.) need to be considered:

> [t]he plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach.

81. In *Jones v. Klassen*, Acton J. awarded just over $13,000 in compensatory damages and $5,000 in punitive damages. Erb J. awarded just over $96,000 in compensatory damages in *Unified Freight*. In both cases, the courts reduced the amount of damages based on an

estimate of the number of clients who would have left the companies regardless of the departure of the former employees.

Summary

82. Generally, the cases indicate that the following issues need to be considered for there to be an enforceable restrictive covenant:

(1) is the restrictive covenant a non-competition clause or a non-solicitation clause? Non-competition clauses are only enforceable in extreme situations and will not be enforced where a non-solicitation clause will suffice: *Elsley*, *Lyons*, *Staebler*. Generally, it is much easier to enforce if the former employee is also a shareholder or the non-competition clause was part of a purchase of the former employee's shares;

(2) is there a proprietary interest to be protected?

(3) are the spatial and temporal boundaries of the restrictive covenant reasonable?

(4) what are the surrounding circumstances? Is the restrictive covenant reasonable taking the surrounding circumstances into account? The nature of the industry may play a significant role; and

(5) is there a severance clause in the restrictive covenant? Is it possible for a court to blue-pencil or notionally read down an offensive passage?

The hypothetical

83. In the hypothetical, the restrictive covenant prohibited John from competing in one paragraph and soliciting in another. This ambiguity would work against the company. Given that John was a general salesperson with little management responsibility; a non-competition clause would likely be unenforceable as being broader than necessary to protect the company's proprietary interest. The temporal restriction of one year is probably in line with the case law. Accordingly, even before *Shafron*, it was unlikely that a court would use notional severance to write down the clauses. Even in the absence of a written confidentiality agreement, John would have a common law duty to not disclose trade secrets or use former customer lists for solicitation purposes. Had the company defined in the restrictive covenant the specific information it considered to be confidential and the improper uses of that information, as in *Jones v. Klassen*, it would have a better chance at preventing John from dealing with former clients.

Part 3: Drafting reasonable non-competition clauses

84. Drafting a reasonable non-competition clause requires a balancing of competing interests and consideration must be given to limiting the restriction only to that which is necessary to protect a company's proprietary interests. As stated above, non-competition

clauses are broader than non-solicitation clauses and non-competition clauses are only permitted in extreme cases. A poorly drafted non-competition clause is doomed from the start.

85. Non-competition clauses are permissible in cases where the former employee was a key employee or a fiduciary or where the employee got some "extra" consideration for the clause; where the employee was also a shareholder or took part in the sale of the business or perhaps is paid a "signing bonus" specifically for the clause.

Employment Contracts vs. Business Purchase and Sale Agreements

86. A court will look at non-competition clauses which are part of a pure employment relationship with greater scrutiny than with non-competition clauses which are part of a sale agreement. The Supreme Court of Canada stated in *Macguire v. Northland Drug Co.*, [1935] S.C.R. 412 at 415 (S.C.C.):

> Public policy, as interpreted by the courts, requires on the one hand that employers be left free to protect from violation their proprietary rights in business, and on the other hand, that every man be left free to use to his advantage, his still and knowledge in trade. In the weighing and balancing of these opposing rights, the whole problem in cases of covenants in restraint of trade it to be found. Less latitude is allowed in the restrictions as between employer and employee than as between vendor and purchaser of good will.

87. Regarding the latter point, the Supreme Court of Canada, in *Elsley*, stated that:

> The distinction made in the cases between a restrictive covenant contained in an agreement for the sale of a business and one contained in a contract of employment is well-conceived and responsive to practical considerations.

88. Further, the Court of Appeal for British Columbia, in *KRG*, stated (paras. 39-40):

> The appellant contends that even if the restrictive covenant is to be considered in the employment context, placing it into its factual matrix allows the Court to apply the approach usually taken to covenants in the context of the sale of goodwill when deciding whether to enforce it.
>
> The Supreme Court of Canada rejected this proposition in *Elsley*. After noting that the Ontario Court of Appeal considered the case did not fit neatly into the category of either employment or sale of goodwill, Dickson J. stated, ". . . I do not think the restrictive covenant of the employment agreement can be fed by the sale agreement. . . It would be wrong. . . to test that agreement by the criteria applicable in the case of a vendor/purchaser agreement, or by some hybrid test".

89. G.H.L. Fridman in *The Law of Contract*, 4th ed, (Scarborough: Carswell, 1999) set out the principles applicable to restrictive covenants in employment contracts at 415:

> To protect the employer's proprietary interest it may be necessary to prevent

> the ex-employee from establishing his own business or working for others so as to be likely to appropriate the employer's trade connection through his acquaintance with the employer's customers. Since the parties may be unequal, a covenant in restraint of trade may be oppressive to the employee. It will be acceptable, however, when its purpose is not to prohibit the employee from exploiting the skills he has required during his employment, but to protect the former employer against competition where the scope and nature of the employee's work and his contact with clients and customers of his former employer is such that he could readily do harm to his employer.

90. As Dickson J. stated in *Elsley* at para. 19:

> Whether a restriction is reasonably required for the protection of the covenantee can only be decided by considering the nature of the covenantee's business and the nature and character of the employment.

91. In *Dreco Energy Services Ltd. v. Wenzel*, 2004 ABCA 95 (Alta. C.A.), the Alberta Court of Appeal allowed an appeal where an application for an interlocutory injunction attempting to have a non-competition clause enforced had been dismissed. Cote J.A. found that the application judge had misconceived the test for an interlocutory injunction by focussing on whether the restrictive covenants were too broad as opposed to following the test in *RJR*. The application judge heard oral evidence for three days. The non-competition clauses were part of a sale of a company at para. 2:

> The plaintiffs were in an overlapping line of business. The individual defendant and the second defendant agreed to sell their business to the plaintiffs for a very large sum of money. The terms of sale were carefully negotiated and documented, and were obviously drafted by lawyers. They specified various other contracts which were to be signed, and were. That included an employment contract. Both the sale contract and the employment contract contained stringent non-competition clauses.

92. In *Anderson v. Berry-Heldt*, 2007 BCCA 100 (B.C. C.A.), the British Columbia Court of Appeal upheld the enforcement of the following non-competition clause which endured for one year after the sale of the party's share pursuant to a shot-gun clause at para. 3:

> Non-Competition – Each Voting Shareholder covenants and agrees with Trilink that the Voting Shareholder shall not, for that Voting Shareholder's Restricted Period either alone or in partnership or in conjunction with any person […] directly or indirectly:….
>
> (c) divert, take, solicit, accept or attempt to divert or take, on behalf of the Voting Shareholder or any other person, any customer or potential customer or supplier or potential supplier of Trilink as of the date of this Agreement, the twelve month period prior to the date of this Agreement or during the Restricted

Period.

93. *Anderson* concerned a travel agency with three equal co-owners. The co-owners entered into a shareholders agreement which included the above non-competition clause. When a dispute between the exiting co-owner, Anderson, and the others arose, Anderson sought a declaration that the non-competition clause was unenforceable. Anderson argued that the geographical restriction of British Columbia, Alberta, Saskatchewan, Manitoba and Ontario was overbroad and unenforceable. Mashuhara J. found the non-competition clause to be reasonable in terms of spatial and geographic scope. The two of key factors that led Mashuhara J. to the conclusion that the non-competition clause was reasonable were "the Restricted Period was negotiated freely by the parties, who were on equal footing when it came to negotiating the shareholders' agreement" and "it is not disputed that the price [Anderson] received for her shares incorporated the value of the non-competition clause."

94. The British Columbia Court of Appeal agreed with Mashuhara J. Further, the Court noted at para. 12: "[a]s a general principle, the courts will look with more particular scrutiny at a covenant designed to protect a pure employment relationship as opposed to a covenant associated with the sale of a business."

95. In *Martinrea International Inc. v. Canadian Hydrogen Energy Company Limited*, 2005 CanLII 36436 (Ont. C.A.), the Court of Appeal for Ontario, in a majority decision, upheld a non-competition clause that was part of an agreement of purchase of sale which included a five year term and a global reach at para. 14: "[the appellant]…shall not enter into a business that is competitive to the business of [the respondent]." While Cronk J.A. found the non-competition clause to be vague and uncertain, and therefore unenforceable, Lang and Armstrong J.J.A. found at para. 7 that the parties were "knowledgeable parties of equal bargaining power" and that the appellant had "executed the agreement fully cognizant of the terms of the restrictive covenant."

96. In *Shafron*, the Supreme Court of Canada stated as follows (paras.23-5):

> The absence of payment for goodwill as well as 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.
>
> An initial question in the present case is whether the restrictive covenant at issue is properly characterized as being contained in an employment contract or a contract for the sale of a business. The December 31, 1987 agreement covering the sale of Shafron's business did not contain a restrictive covenant. However, the agreement he entered into in early 1988 did. Whether the restrictive covenant in the 1988 agreement should be construed as being in relation to the sale of the business and the $700,000 goodwill payment is not the issue before the Court.

> After Shafron sold his business, KRG Western was sold again in 1991 to Intercity. Shafron received no payment on account of goodwill when the shares of KRG Western were sold to Intercity. The contract in which the restrictive covenant at issue in this case was contained was entered into in 1998, some 11 years after Shafron sold his business and after it was sold a second time. The 1998 employment contract was entirely independent of the 1987 sale agreement and 1988 agreement. The fact that the restrictive covenant in the 1998 employment contract originated in the 1988 agreement has no bearing on the interpretation of the 1998 employment contract. The 1998 agreement is an employment contract and, as found by the trial judge, the reasonableness the restrictive covenant must stand up to the more rigorous test applicable to employment contracts.

97. *Unified Freight*, mentioned earlier, also dealt with the enforceability of a non-competition clause in a purely employment relationship. Erb J. found the following non-competition clause to be reasonable at para. 19:

> For a period of one year after an individual leaves the employ of Unified Freight Services Ltd., they shall not be in contact with any customer of the Company for the purposes of freight forwarding. If such contact is made, civil or criminal charges will be laid against the ex-employee.

98. The broad scope of the non-competition clause was only reasonable to Erb J. due to the nature of the employment relationship and the employer's business in general at paras. 56-57:

> It is clear in the circumstances of this case that Mr. Therriault had "scope for the exercise of discretion." He was a supervisor. He was charged with the responsibility of directing employees in the appropriate exercise of their duties. He held a position of influence as a member of "top management", and he had a broad scope for the exercise of discretion such as having had full access to and shared control of, Unified's information. In the absence of Mr. Walters, Mr. Therriault and his co-supervisor were responsible for determining whether other employees could use the company cell phone and remove confidential documents in accordance with company policies. Mr. Therriault's discretion affected Unified's legal and practical interests. Those interests included Unified's proprietary, exclusive interest in its customer information.
>
> Further, Mr. Therriault had the power to access company information and appropriate it to his own use potentially to the detriment of Unified, if he so chose. I am satisfied that the nature of the freight forwarding business is such that customer and service-supplier contacts are a company's stock in trade. Wrongful appropriation of those contacts removes the essence of the business of freight forwarding enterprises. In that sense, Unified was peculiarly vulnerable to and at the mercy of Mr. Therriault to whom it had entrusted the enforcement of its policies, supervision of its employees, and control of its

> contact information. Armed with this information, Mr. Therriault could position himself as a competitor or with a competitor very quickly to Unified's disadvantage.

99. For a non-competition clause to be successfully enforced, as in *Unified Freight*, a company will have to show that the former employee was sufficiently important within the company and the company is particularly vulnerable to the former employee's use of proprietary information. Without proof of these two factors, courts may find that circumstances are not sufficiently extreme to merit a non-competition clause.

Business Purchase and Sale Agreements – A Recent Case

100. *Islip v. SSI Equipment Inc.*, 2009 CanLII 32704 (Ont. S.C.) shows that exceptionally broad restrictive covenants can still be found to be enforceable if, in the context of a share purchase agreement, the employees and former shareholders clearly agree to the strict terms of the restrictive covenants. *Islip* dealt with a family business which was sold with the family members remaining on as employees with broad non-competition, non-solicitation and non-disclosure clauses. The Islip family business, SSI, manufactured industrial parts and was run by four members of the Islip family along with other relatives. The Islip family was well known throughout the industry and was the main source of SSI's goodwill, estimated at $2.7 million at the time of the purchase of SSI; Justice Tucker stated at para. 64, "The goodwill of SSI at the time of the purchase would have centred in the Islips. They were the four key players in the SSI organization, covering all aspects of the corporation including engineering, management, marketing, and drawing."

101. The Islips sold SSI to Circor International, Inc. ("Circor") for $3.2 million by way of a share purchase agreement over 500 pages long. The four key Islips stayed on as employees with 3 year non-competition and non-solicitation clauses and a 10 year non-disclosure clause. Shortly after the expiration of the 3 years, one Islip left SSI, followed shortly by the rest of the Islips and other employees of SSI. A competing company was formed, Islip Flow Controls Inc. ("IFC"). Within 2 years of the Islips' departure and the beginning of IFC, SSI's business deteriorated so significantly that it ceased operations in Canada.

102. The non-competition clause was exceptionally broad, including all manner of relevant competition with no geographical limit:

> 2.01 **Non-competition**
>
> (1) Each of Shareholders, in order to induce the Purchasers to enter into this Agreement and the Share Purchase Agreement, expressly covenants and agrees that neither the Shareholders nor any of their Related Parties will, directly or indirectly, for a period of three (3) years following the Closing Date own, manage, operate, join, control, promote, invest or participate in or be connected with in any capacity (either as an employee, employer, trustee,

consultant, agent, principal, partner, corporate officer, director, creditor, owner or shareholder or in any other individual or representative capacity) any Competitor anywhere in Canada, the United States and the countries listed on Schedule A hereto, as such Schedule may be amended or supplemented from time to time at the sole discretion of the Corporation or IOG.

SCHEDULE A
ADDITIONAL COUNTRIES

Argentina
Australia
Belgium
Chile
Hong Kong
India
Israel
Kuwait
Lebanon
Malaysia
Mexico
The Netherlands
New Guinea
New Zealand
Puerto Rico
Singapore
Spain
Taiwan
United Arab Emirates
Venezuela

"Competitor" includes any business, venture, individual, partnership, firm, corporation or other entity engaged wholly or partly in the design, manufacture, development, distribution, marketing or sales of any of the competing products.

103. On its face, the non-competition clause appears to be unreasonably broad even in the context of a share purchase agreement. However, Justice Tucker found the non-competition clause to be enforceable for the following reasons at para. 82:

> Although this restrictive covenant appears on its face to be very wide, and thus potentially unenforceable, the Islips acknowledged in Article 2.02 that the restrictive covenants as set out in the Agreement were reasonable. They also agreed that a breach would result in irreparable harm to the purchased corporation and would adversely affect the goodwill being transferred and the value of the shares.

104. The non-solicitation clause was as broad and comprehensive as the non-competition clause but was also enforceable given the Islips' acknowledgement in the share purchase agreement that the strict terms were valid:

> 2.02 **Non-Solicitation**
>
> (1) Each of the Shareholders shall not in any manner whatsoever, without the prior consent of each of the Corporations and the Purchasers, at any time during a period of three (3) years from the Closing Date, directly or indirectly:
>
> (a) induce or endeavour to induce any employee of the Corporation, the U.S. Corporation, IOG, WIC, or any of their respective Affiliates to leave his or her employment;
>
> (b) employ or attempt to employ or assist any person to employ any employee of the Corporation, the U.S. Corporation, IOG, WIC, or any of their respective Affiliates; or
>
> (c) solicit, endeavour to solicit or gain the custom of, canvass or interfere with the Corporation's, the U.S. Corporation's, IOG's or WIC's or any of their respective Affiliates' relationships with any person that:
>
> (i) is a customer of the Corporation, the U.S. Corporation, IOG or WIC or any of their respective Affiliates with respect to the Competing Products at the date hereof;
>
> (ii) was a customer of the Corporation, the U.S. Corporation, IOG or WIC or any of their respective Affiliates with respect to the Competing Products at any time within thirty-six months prior to the date hereof; or
>
> (iii) has been pursued as a prospective customer with respect to the Competing Products by or on behalf of the Corporation, the U.S. Corporation, IOG or WIC or any of their respective Affiliates at any time within thirty-six months prior to the date hereof, and in respect of whom the Corporation, the U.S. Corporation or any of their respective Affiliates has not determined to cease all such pursuit.
>
> (2) Each of the Shareholders agrees that the restriction in Section 2.02(1) is reasonable in view of the nature of the Business and the international market for each of the Corporations' products and services and that any breach thereof would result in continuing and irreparable harm to the Purchasers or any of them and would adversely affect the value to IOG of the Shares and the value to WIC of the Subsidiary Shares and the related goodwill being transferred under the Share Purchase Agreement. The Shareholders further agree to waive all defences to the strict enforcement of the restriction in Section 2.02(1).

105. Justice Tucker found that there was insufficient evidence to find that the Islips had breached either the non-competition or non-solicitation clauses, despite the clauses' wide breadth. Justice Tucker found that there was no direct evidence of any breaches and that SSI was relying on inferences being drawn to prove breaches. Justice Tucker refused to draw such inferences.

106. As with the other clauses, the non-disclosure clause was drafted to be exhaustive:

> 2.03 **<u>Non-Disclosure</u>**
>
> (1) Each of Shareholders, in order to induce the Purchases to enter into this Agreement and the Share Purchase Agreement, expressly covenants and agrees that none of the Shareholders will, directly or indirectly, for a period of ten (10) years following the Closing Date, disclose or furnish to any person, other than any of the Purchasers, any proprietary information or confidential information (including, without limitation, trade secrets) of or concerning the Corporation, the U.S. Corporation, IOG, WIC or any of their respective Affiliates. Each of the Shareholders further acknowledges and agrees that he/she will take all steps necessary to protect the confidentiality of such information from disclosure.
>
> (2) Each of the Shareholders promises and agrees not to reproduce or disclose to any other person or entity any proprietary information or confidential information (including, without limitation, trade secrets) of or concerning the Corporation, the U.S. Corporation, IOG, WIC or any of their respective Affiliates, unless:
>
> > (i) specifically authorized in writing in advance by the President of each of the Purchasers to do so (within their sole and absolute discretion) and if the President of each of the Purchasers gives a Shareholder written authorization to make any such disclosure, such Shareholder shall do so only within the limits and to the extent of the authorization; or
> >
> > (ii) required by legal process. In the event that any of the Shareholders is compelled by legal process to disclose any information, such Shareholder shall promptly notify the Purchasers of such obligation and cooperate with the Purchasers in their efforts to obtain an order preventing disclosure of the information. If the Purchasers are unsuccessful in their efforts to obtain an order, then such Shareholder shall only disclose such information as legally required in response to the legal process in the reasonable opinion of such Shareholder's legal counsel.

107. At trial, the Islips admitted to taking confidential information from SSI and using that information for IFC. The extent of the Islips' conversion was not even known by their counsel and the trial was lengthened in attempting to uncover the extent of the conversion. Ultimately, Justice Tucker found that the Islips copied and used SSI materials including a manual, a catalogue, a business plan, disks, and engineering plans.

108. Justice Tucker found that the Islips had breached the non-disclosure clause and rejected the Islips' argument that they were entitled to use the SSI information, at paras. 92 and 93:

> [92] On the evidence it is clear that these articles were breached, although there is some question as to the extent of the disclosure and the definition of proprietary and confidential information. It is the position of the defendants that *any* information, *any* material of SSI, is deemed to be confidential information and, accordingly, any use of such material by the Islips is a breach of this covenant. It is the position of the plaintiffs that the definition of confidential information is much more narrow and is undefined in the Agreement. The plaintiffs also point to the fact that there is no covenant not to "use" the material. The plaintiffs also argue that the information was not disclosed to anyone other than to the Islips' own corporation and as such is not technically a breach of the covenant.
>
> [93] With respect to the plaintiffs' argument it may be that every piece of information may not be confidential in law and I agree it is not a defined term under the multi-paged contract. But the plaintiffs' acts including conversion of substantially all the information of the company SSI, itself an actionable tort, was clearly a breach of these articles by the use of the drawings, the use of the quality control manual, and the banking proposal. In fact, given the wording of the article, it would appear that there is little the Islips could have done without breaching this covenant if they planned to go into the same business. The covenants are, in fact, a 10-year non-compete if one interprets it as widely as the defendants suggest. The Islips knew the customers and the suppliers of SSI. By disclosing these directly or indirectly to IFC and "using" it to their benefit, I find that they are in breach of the covenant.

109. The "potentially unenforceable" restrictive covenants in *Islip* were found to be enforceable given the employees' clear acknowledgement that the strict terms were necessary as part of the share purchase agreement and in circumstances where a large amount of money was paid for the company. It is unclear whether the restrictive covenants would have been found to be enforceable in the absence of a share purchase agreement or in circumstances where very little was paid for the company; the consideration factor clearly played a large part in the enforceability of the restrictive covenants, but it is unclear by how much. However, *Islip* shows that otherwise unenforceable restrictive covenants can be enforceable when they are necessary for a substantial sale of the business.

Summary

110. Overall, when drafting a non-competition clause, the following issues should be considered:

(1) are there clear terms including the limits in terms of space, time and the type of prohibited work?: *Lyons, Shafron*

(2) is the non-competition clause designed to protect a pure employment relationship or is it a covenant which is part of a sale?

(3) are there exceptional circumstances to merit a more restrictive clause? A non-competition clause can only be used in exceptional cases where the employee had a more fundamental role in the business, i.e. where a non-solicitation clause would be insufficient to protect the reasonable proprietary interest of the employer (certain businesses by their nature may require such protection and others are such that such protections will rarely be enforced); and

(4) is the non-competition clause designed to restrain the employee from using the skills which were acquired in employment or the trade secrets? A limit on an employee's skills is more difficult to enforce. Does the non-competition clause attempt to create a business monopoly over a defined area or is it a specific limit meant to protect a proprietary interest?

The hypothetical

111. Changing the hypothetical slightly, if John had been hired as a senior officer making him a fiduciary instead of a general salesperson, and if the business was of a type so that a non-solicitation clause was insufficient protection for the employer, a non-competition clause may have been appropriate. Further, if John was a shareholder who had received some consideration for his shares as a result of a sale before leaving, a non-competition clause would have likely been part of the sale.

Part 4: Enforcing restrictive covenants

112. Typically the fight with respect to restrictive covenants takes place at the outset with the former employer seeking injunctive relief before "the horse is out of the barn" and customers are lost.

113. The classic test for an injunction is set out in *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311 (S.C.C.):

(1) is there a serious question to be tried?

(2) will the moving party suffer irreparable harm if the injunction is not granted? and

(3) does the balance of convenience favour the moving party?

114. Recently in Ontario, Strathy J. dealt with an interlocutory injunction regarding former employees: *Precision Fine Papers Inc. v. Durkin*, 2008 WL 526157 and additional reasons (2008), 2008 CarswellOnt 1560 (Ont. S.C.J.). Perell, J. granted the plaintiff, Precision Fine Papers Inc. ("Precision") an interim interlocutory injunction against two former employees, James and Wendy Durkin, and their new employer, Inter-World paper Overseas Limited ("Inter-World") prohibiting them from soliciting customers of Precision. The interim injunction was for a three month period. Strathy, J., extended that interlocutory injunction for an additional six months.

115. James Durkin was Precisions' former president, a position he held for over a decade. His

daughter, Wendy, worked in sales at Precision. James Durkin's employment contract with Precision contained a confidentiality provision and a non-solicitation clause that provided he would not solicit or attempt to solicit any customer of Precision for a period of six months. Strathy J. found the non-solicitation clause to be reasonable on its face. Wendy Durkin had no employment contract. She resigned from Precision and began working for Inter-World shortly afterwards. James Durkin resigned from Precision and informed clients he was retiring. Shortly after he resigned from Precision, James Durkin began working for Inter-World as a "part-time unpaid consultant" which was to last until the six-month non-competition clause ended, at which time he would be a full-time paid employee of Inter-World. Neither James nor Wendy Durkin informed Precision that they were working for Inter-World; Precision discovered that the Durkins were working for Inter-World roughly three months after they began. Strathy J. found that there was substantial evidence to find that Inter-World was aware of James Durkin's non-solicitation agreement with Precision and that over 20 of Precision's former clients had switched to Inter-World.

116. For the first part of the *RJR* test, Strathy J. considered *Boehmer Box L.P. v. Ellis Packaging Ltd.*, [2007] O.J. No. 1684 (Ont. S.C.J.) and *Sherwood Dash Inc. v. Woodview Products Inc.*, [2005] O.J. No. 5298 (Ont. S.C.J.) and stated at para. 17 "[t]hese authorities suggest that where an interlocutory injunction will interfere with the defendant's ability to make a living, the threshold should be higher than one of a strong *prima facie* case." A strong *prima facie* case is not a high test, but here Strathy J. suggests that the test needs to be raised where there is potential interference with a defendant's ability to make a living. Essentially, a plaintiff must show that there is strong, not just basic, evidence that a serious question is to be tried before the second part of the test can be considered.

117. The second part of the test, regarding irreparable harm, deals with the nature of the harm, not its magnitude, and is harm that cannot be quantified in monetary terms or cured (*RJR*, supra, at 341; *Precision*, supra, at para. 24). Strathy J. found at para. 28 that Precision's business would be "eviscerated" if the Durkins' conduct was not enjoined.

118. For the balance of convenience, the third part of the test, Strathy J. found at para. 29 that Precision needed "a reasonable period of time to enable it to re-establish customer relationships undermined by the defendants' conduct" and at para. 39 that Precision needed "the necessary tranquility and stability to repair its business relationships, let alone take measures to solidify them." Strathy J. also found at para. 30 that a continuation of the injunction would not prevent Inter-World "from engaging in all the considerable business activities in which it was engaged prior to the employment of the Durkins" and would not prevent the Durkins and Inter-World "from competing fairly in the substantial marketplace of non-Precision customers." Strathy J. found at para. 40 that Precision was in a more vulnerable position than the defendants. The sub-text of Strathy J.'s comments appears to be not so much whether the balance of convenience favours one side but whether one side would be seriously harmed by the presence or absence of the injunction. As with the serious question part of the test, the balance of convenience test appears to need more weight to tip it to one side.

119. Strathy J. granted an extension of the injunction beyond the 6 month period of the employment contract. Strathy J. stated at para. 38: "[t]o limit the injunction to the six month period would be to give the defendants the fruits of their breach and would fail to adequately protect the plaintiff's legitimate interest in its customer base."

120. Strathy J. also allowed the parties to make submissions on additional terms of the injunction. In additional reasons, Strathy J. ordered that the defendants return all confidential information and maintain all business records but refused to prohibit Inter-World from doing business with Precision's former clients. Citing Nordheimer J. in *Jet Print Inc. v. Cohen*, [1999] O.J. No. 2864 (Ont. S.C.J.), Strathy J. at para. 10 found that such an order would be "an unreasonable interference with the rights of Inter-World's customers, who are not before the Court. Compelling them to stop doing business with a supplier would be a significant interference with contractual relationships and could have consequences about which I know nothing."

121. Although it was not argued in *Precision*, it is possible to conclude that a non-competition clause may have been appropriate for James Durkin, the former president of the company and a fiduciary, while a non-solicitation clause may have been appropriate for Wendy Durkin, a general salesperson. However, there are cases where the courts have said that the more junior person is "tainted" by the more senior, so that both must be enjoined (see *Albert et al. v. Mount Joy et al.* 79 D.L.R. (3d) 108).

122. *BMO Nesbitt Burns Inc. v. Ord*, [2007] O.J. No. 2620 (Ont. S.C.J.) dealt with investment advisors who left BMO Nesbitt Burns ("Nesbitt") and immediately began working for a competitor, RBC Dominion. Nesbitt sought an injunction enforcing the former employees' common law duty to not solicit and not use confidential information. While Pattillo J. found that Nesbitt passed the first part of the *RJR* test, he refused to grant the injunction after having found that Nesbitt did not prove irreparable harm if the injunction was not granted. Pattillo J.s stated at para 39:

> In my view, the harm which Nesbitt submits it will suffer as a result of the defendants' alleged activities is capable of being quantified in monetary terms and is recoverable in the event it is found owing…. It will not be difficult, therefore, to quantify the number of lost clients, the value they contributed to Nesbitt before their departure and the value they contributed to Dominion going forward.

123. In contrast, Pattillo J. granted an injunction enforcing a non-competition clause that was part of the sale of a dentistry business. In *Dr. Alain Nourkeyhani Dentistry Professional Corp. v. Pakroo*, 2008 WL 2359087 (Ont. S.C.J.), Pattillo J. stated regarding irreparable harm at para. 4:

> There is no question that the Defendant's actions in competing within 10 kilometers, contacting patients, soliciting staff have a significant impact on the Plaintiff and its business. The Plaintiff has established a loss of customers. Beyond that, defendant's actions in advertising and soliciting have the direct

> effect of diminishing good will. The end result, in my view, is that the Defendant's actions have impacted irreparable harm on the Plaintiff.

124. In *645245 Ontario Ltd. v. 1304613 Ontario Ltd.* 2006 WL 2524317 (Ont. S.C.J.), the company ("645245") sought an injunction enjoining the defendants from soliciting or accepting business from customers of their former partner/employer in an insurance business. There were non-solicitation clauses regarding customers of the former employer for a period of 2 years. Lane J. dismissed the motion, stating at para. 16:

> In summary, the plaintiffs have failed to establish a sufficient case on the merits to support an injunction until trial. The covenant is overbroad temporally and in its extension to accepting business when offered without solicitation. They have not established that the movement of the five customers is related to solicitation as opposed to an unsolicited migration to follow a trusted advisor. The evidence does not establish that irreparable harm is likely to occur and none has been shown to date. The balance of convenience does not favour granting an interlocutory injunction which would amount to a total victory for the plaintiff without them having to prove their case.

125. In *Corporate Images Holdings Partnership v. Satchell*, [2008] B.C.W.L.D. 4133 (B.C. S.C.) the plaintiff sought an interlocutory injunction to enforce a non-competition/non-solicitation agreement. Allan J. dismissed the motion stating that the plaintiff had not successfully made out a *prima facie* case that the employment agreements were enforceable, had not shown irreparable harm, and that the balance of convenience did not favour the plaintiff.

126. In *Trapeze Software Inc. v. Bryans* (2007), 154 A.C.W.S. (3d) 944 (Ont. S.C.), a software research and development company sought to enforce non-competition agreements signed by former employees. Newbould J. dismissed a motion for an interlocutory injunction finding that the plaintiff had not made out a *prima facie* case that the non-competition and non-solicitation clauses were enforceable. In finding that the non-competition clause was too broad, Newbould J. quoted Perell J. from *Sherwood Dash* at 41:

> Further, as a solution, the non-competition clause in this case extends beyond the actual problem of the misappropriating of confidential information. Put somewhat differently, it is not that the former employee is competing; it is how the former employee competes. By absolutely foreclosing employment for any competitor anywhere, the covenant in this case precludes the employee from using acquired skills or knowledge that do not encroach on confidential information or the employer's proprietary interests. It is arguable in the immediate case that the restrictive covenant goes too far; colloquially speaking, it is "overkill."

127. In *Four Star Dairy Ltd. v. Iozzo*, 2005 CarswellOnt 8052 (Ont. S.C.J.), Murray J. dismissed a motion for an interlocutory injunction enforcing a non-competition clause and also on grounds that the defendant not disclose confidential information. Regarding the non-

competition clause, Murray J. found that it was too broad given that there was no geographic limitation or boundary as to the type of work which was prohibited. Further, Murray J. found that the plaintiff had not shown irreparable harm under the *RJR* test since there were insufficient facts to establish that the plaintiff's reputation would be irreparably harmed by the possible spreading of rumours by the defendants of the solvency of the plaintiff.

128. In *Industrial Rush Supply & Service Ltd. v. Faria* (2003), 32 B.L.R. (3d) 306 (Ont. S.C.J.), Hoy J. granted an injunction enforcing non-solicitation and non-disclosure clauses in an employment contract but had difficulty regarding the type of prohibited work in restrictive covenants regarding a shareholder's agreement at paras. 15-16:

> In the context of a sale of a business, a geographical scope restricted to 60 kilometers from the locations at which business was conducted is *prima facie* reasonable. These are not Ontario-wide or Canada-wide covenants. Mr. Faria continued to be the "face" of the business, and a minority shareholder. It is not unreasonable that the geographic scope of the covenant is measured from locations in existence at the time he ceased to be employed, as opposed to those in existence at the time that he sold his 80% interest.
>
> The difficult question is whether a covenant not to engage in a "similar" business is *prima facie* enforceable. I think that such a covenant is overly broad, whether the standard applied is serious issue to be tried or *prima facie* case. Dictionary definitions of "similar" include "of a like nature or kind". (See The Shorter Oxford English Dictionary, Third Edition.) Clearly, it would have been safer to specify what business Mr. Faria could not conduct, or to restrict him from engaging in a similar business that competes with Industrial Rush's business. A similar business does not necessarily compete.

129. Hoy J. noted that the restrictive covenants had severability clauses.

130. Not all courts provide a thorough application of the *RJR* principles. In *Spring Fresh Cleaning & Restoration Canada Inc. v. Campeau*, [2008] A.W.L.D. 1819 (Alta. Q.B.), Wilson J. granted an interlocutory injunction enforcing a non-competition clause against a former employee for a period of one year and a 150 km radius. However, Wilson J. cited no cases in the judgment and merely stated at paras. 5 and 6:

> The clause is reasonable; it is limited in time and scope to such an extent that it does not overreach. On [the defendant's] own evidence on discovery there is prima facie proof. The clause is only for one year, and it now has only some 6 more months to run, the Defendant has been competing for 6 months of the prohibited term.
>
> In my opinion, the tripartite test is met in this case….

131. *Spring Fresh* provides far less than the discussion of reasons which has become

customary in similar cases. While the "tripartite test" Wilson J. refers to is clearly the interlocutory injunction test in *RJR*, there is no detailed discussion of whether the non-competition clause was reasonable as there was in *Esley*, *Lyons*, *Staebler*, *MD Management*, etc.

132. A lack of discussion of the *RJR* principles may increase the validity of an appeal. In *Steinbach Credit Union Ltd. v. Hardman*, [2007] 9 W.W.R. 208 (Man. C.A.), the Court of Appeal for Manitoba found at para. 17 that the motions judge "did not engage in the analysis required by *RJR*. As a result, he erred in principle and this court is entitled to exercise fresh discretion after a consideration of the appropriate principles." However, the Court of Appeal largely upheld the enforcement of the restrictive covenants with some variation of the scope of the injunction.

A party seeking to enforce a restrictive covenant must move quickly

133. Once a company becomes aware that a former employee is breaching a restrictive covenant, it must move quickly to enforce the restrictive covenant or else any right to injunctive relief may be lost. The urgency with which a party moves essentially becomes evidence in and of itself in support of the argument that the situation is sufficiently grave to merit the extraordinary equitable relief of an injunction.

134. A party seeking to enforce a restrictive covenant through an interlocutory injunction must do so without delay once it becomes aware of "the nature and extent of the defendant's activities": *Precision*, at paras. 35-36. A delay in applying for an injunction is considered when deciding whether the injunction should be granted: *911887 Ontario Ltd. v. LeBlanc*, [2002] O.J. No. 2991 (Ont. S.C.J.); *Husar Estate v. P. & M. Construction Ltd.* (2007), 281 D.L.R. (4^{th}) 305 (Ont. C.A.); *Precision*, supra, at 35-36.

135. In *Dr. Jack Newton Dentistry Professional Corporation v. Towell*, 2005 CanLII 37351 (Ont. S.C.J.), Smith J. granted an injunction enforcing a non-competition clause of 3 years and a 15 km radius, and stated at para. 29:

> …[W]here there is a plain and uncontested breach of a clear covenant not to do a particular thing and the covenant or promptly begins to do what he has promised not to do, then, absent special circumstances, it seems to me that the sooner he is compelled to keep his promise the better.

Injunctions without a restrictive covenant

136. Even if there is no formal written restrictive covenant, a former employer can seek an injunction based on a common law duty: *2135396 Ontario Inc. v. Invirontech Mechanical Inc.*, [2008] O.J. No. 805 (S.C.J.). Consequently, even if there had been no non-solicitation clause in *Precision*, the company could have still sought an injunction against James Durkin based on his former fiduciary duty.

137. In *Western Tank & Lining Ltd. v. Skrobutan*, [2006] 12 W.W.R. 376 (Man. Q.B.), four former employees worked as salesman for Western Tank & Lining Ltd. ("Western Tank") which sold and installed geosynthetic liners and steel tanks. The former employees never agreed to a non-competition clause; they resigned at the same time from Western Tank each giving two weeks' notice and began to compete with Western Tank as part of a newly formed partnership. Western Tank sough an injunction against the former employees, not on grounds that they were prohibited from competing, but because they were key employees and the abrupt manner of their exit breached their fiduciary duty. Scurfield J. granted the injunction, stating that the former employees owed a common law duty to Western Tank, and prohibited them from soliciting Western Tank's private customers for approximately 6 months.

Summary

138. Consequently, for an injunction, the moving party will have to prove:

(1) more than a *prima facie* case regarding whether there is a serious question when an injunction will interfere with the defendant's ability to make a living: *Boehmer Box*; *Sherwood Dash*; *Precision*;

(2) that it will suffer irreparable harm if the conduct of the defendant is not enjoined;

(3) as with the serious question part of the test, more than a simple balance of convenience may be required; and

(4) that it has moved without delay in applying for the injunction: *911887*; *Husar*; *Precision*.

139. Further, a company hiring an employee should ensure it knows whether that employee has any restrictive covenants which would affect the company. Strathy J. found at para. 23 that Inter-World "was aware from the outset of Mr. Durkin's non-solicitation agreement and it may be liable for any breaches of his obligations, both contractual and common law." These are not words a company likes to hear.

The hypothetical

140. In the hypothetical, John's former company would have to move quickly to enforce the restrictive covenant; the timeframe given of four months would be reasonable if it was not immediately aware of John's defection. Further, John's new company should have determined at the time of hiring how John's restrictive covenant affected it.

Conclusion

141. Before an employee and employer relationship even begins, a company should consider

the ramifications of what could happen when the relationship ends. A company should specify what it considers to be its proprietary interest and the type of conduct which will unfairly prejudice its business. For instance, the provision of significant training, relationships with clients and other such legitimate interests should be referenced. It will not be possible, or even necessary, to attempt to cover all possible scenarios. However, courts will be more likely to protect a company's interests later on if it reasonably dealt with these issues at the beginning of the relationship.

142. It is critical in any attempt to restrict a former employee's conduct that the limits it intends to impose are reasonably tailored to only protect its interests. Going beyond that which is reasonably necessary risks having all requested limits denied. Courts are not merely reluctant but, post-*Shafron*, have very limited jurisdiction to impose what they consider appropriate limits in circumstances where a company attempted to restrict more than was necessary. Notwithstanding severance clauses, courts generally will and can only blue pencil provisions which are "trivial and not part of the main purport of the restrictive covenant", and are now prohibited from notionally severing such clauses in employment contracts. Further, severance is not available to clarify an ambiguity in a restrictive covenant, let alone rewrite it into an appropriate restriction. While former employees have common law duties to not unfairly use a company's proprietary interests, a company's best protection is a well-defined and reasonable contractual duty it can attempt to enforce at the first indication of a breach. Finally, think about having specific consideration for the covenant, do not include alternative restrictions, and consider re-negotiating alternative or other ambiguous clauses. The more contemplation a company gives to its interests at the beginning of an employer and employee relationship, the greater chance it has to protect itself once that relationship ends.

143. All that being said, the cases are numerous, often inconsistent, very fact based and supportive of numerous different interpretations. Given the unpredictability, be very careful with any opinions that you give on any restrictive covenants in an employment context.

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Neo Tuytel is a senior business litigator whose practice emphasizes insurance coverage, contractual disputes of all kinds, and environmental matters. He routinely litigates and negotiates to completion complex, high value cases, and has had notable successes in the Supreme Court of Canada. He also acts as co-counsel with lawyers from other firms, and as a consultant to other lawyers.

Neo's insurance practice is conducted mainly on behalf of policyholders, enforcing insurance companies' duty to defend liability claims and obligation to indemnify property losses, as well as prosecuting claims for negligence against insurance brokers. His environmental practice focuses on liability for the cost of clean-up and remediation of contaminated sites.

Neo is a recognized authority on insurance coverage and, as described below, a prolific author and speaker, the editor of a national insurance law publication, and an executive member of the coverage committee for Canada's leading insurance and defence lawyer's organization.

The balance of Neo's practice involves claims for breach of contract, fiduciary duty, appellate advocacy, mediation, and commercial arbitration.

Neo obtained his LL.B. from the University of British Columbia in 1984, was called to the B.C. Bar in 1985, and was accredited as a mediator in 1994.

Before joining Fraser Litigation Group as a founding partner, Neo practiced as associate counsel at a Vancouver-based firm specializing in insurance and maritime law.

Representative Work

- *Shafron v. KRG Insurance Brokers* (2009): Successful appeal to the Supreme Court of Canada on behalf of a well-known Vancouver-area insurance broker. This is the leading case in Canada on the enforceability of restrictive covenants, severance of clauses in employment contracts, and rectification of contracts generally.

- *Family Insurance v. Lombard Canada* (2002): Successful appeal to the Supreme Court of Canada on behalf of a personal lines insurer, setting a precedent with respect to overlapping coverage between insurance policies (in this case, between residential and group liability insurance, for an equestrian accident which caused catastrophic injuries).
- *Kruger Products v. First Choice Logistics* (2013) and *North Newton Warehouses v. Alliance Woodcraft Manufacturing* (2005): Successful appeals to the B.C. Court of Appeal (*Kruger v. First Choice* being worth more than $16 million), and dismissal of applications for leave to appeal to the Supreme Court of Canada. These are the two leading B.C. cases on insurance covenants in contracts, 'tort immunity', and the resulting bar to subrogation for loss or damage to premises or contents.
- Britannia Mine remediation order process and settlement of all claims (under B.C. *Environmental Management Act*) – see Bar Association newsletter and BC government powerpoint backgrounder (2001): As lead counsel for a potentially responsible party (a former Canadian subsidiary), orchestrating a precedent-setting, multi-party agreement to solve one of North America's worst pollution problems: approximately $75 million clean-up of acid rock drainage into Howe Sound from the historic Britannia Mine; thereby avoiding court proceedings and pre-empting the issuance of a remediation order,
- Arbitration of product handling rate at marine terminal (2010): As lead counsel for a shipper of specialized products for overseas markets, arbitrating the rate for handling products at a multi-purpose bulk cargo terminal during an optional contract extension period, obtaining an award at less than half of the 'costs plus profit' rate sought by the terminal, and recovering the vast majority of the client's actual legal costs.

Professional and Community Affiliations

Canadian Journal of Insurance Law, General Editor (2008)

Canadian Bar Association and B.C. Branch (Civil Litigation, Insurance, Environmental, and ADR subsections), member

Member of the Law Society of British Columbia (1985)

B.C. Lawyers Assistance Program, volunteer (2006) and Director (2011)

Our Lady of Perpetual Help, Parish Council (former member)

Canadian Defence Lawyers, Insurance Coverage Committee, Vice-Chair (former)

Publications

"Restrictive Covenants In Employment Contracts: The Latest Developments You Need to Know to Protect Your Interests", 2009 - with Gary Luftspring and Sam Sasso of Ricketts Harris LLP, Toronto

"Who's on the Risk (and for How Much?): Allocating and Apportioning Indemnity and Defence Costs Among Insurers in Canada", updated 2008

“Environmental Liability and Insurance Coverage in British Columbia”, updated 2006 - with Jon Hodes of Miller Thomson LLP, Vancouver

“Fraudulent Property Insurance Claims”, updated 2006 - with Krista Prockiw of Alexander Holburn Beaudin & Lang LLP, Vancouver

“Design Professionals' Errors and Omissions Coverage”, updated 2004

“Sexual Misconduct Claims and Insurance Coverage”, 1997