LABOUR & EMPLOYMENT LAW

Non-competition agreements rarely pay off

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Recent decisions of the Supreme Court of Canada and the Ontario Court of Appeal signal a renewed opposition to non-competition covenants in employment agreements. Since non-competition agreements will be enforced in only the rarest of circumstances, the most effective way to curtail the injurious effects of senior employee departures may be to use carefully drafted agreements prohibiting the solicitation of former clients and former co-workers.

In *RBC Dominion Securities v. Merrill Lynch*, [2008] S.C.J. No. 56, the branch manager and substantially all of the investment advisors at the RBC Dominion Securities (DS) branch in Cranbrook, B.C. left for Merrill Lynch, practically across the street.

The Supreme Court of Canada found the branch manager's employment contract contained an implied term that he take reasonable steps to retain for DS the DS employees who were under his supervision, and that he breached his contractual duty of good faith. Merrill Lynch was also found liable for having induced his breach of contract.

However, and very significantly, the Supreme Court did not award any damages arising out of the competition by the newly departed investment advisors in their new firm. The court was clear that a departing employee is free to compete with his or her former employer at common law; DS's remedy against the departed investment advisors was limited to damages for failure to give reasonable notice. The court implied that any obligation not to compete must arise other than at common law, for example by operation of an express non-competition agreement.

> **The Court of Appeal concluded that non-competition clauses should only be enforced in exceptional circumstances.**

Notwithstanding that *RBC Dominion Securities* can be read to imply that a written non-competition agreement can impose a duty not to compete that would not otherwise arise against an employee at common law, in *Shafron v. KRG Insurance Brokers (Western) Inc.*, [2009] S.C.J. No. 6, the Supreme Court of Canada clarified that employee non-competition agreements will be subject to such careful scrutiny that they will rarely be enforced.

In *Shafron*, a former owner of an insurance agency remained on as an employee after he sold his business. He entered into a series of employment agreements that included a term that, for three years after leaving his employment (except for termination without cause), he would not be employed in another insurance brokerage in the "Metropolitan City of Vancouver." The business later changed hands again, and Shafron left to go work at an insurance agency in Richmond, B.C.

The issue on appeal was whether the restrictive covenant could be "read down" or "blue-lined" or otherwise could prohibit him from working in the insurance brokerage business in Richmond, B.C., since "Metropolitan City of Vancouver" had no legal meaning.

The Supreme Court held that restrictive covenants will be presumed to be unenforceable; a party seeking to enforce a restrictive covenant has the onus to show it is reasonable. Even more rigorous scrutiny of restrictive covenants in employment contracts is justified, principally because of the imbalance of power traditionally assumed to imbue the employment relationship. Non-competition agreements that would restrict former employees from working in their field must be reasonable in their geographical scope and for the length of time they would apply.

In *Shafron*, notwithstanding that there should have been no doubt that Richmond is in "metropolitan Vancouver," the court found the term "Metropolitan City of Vancouver" inherently ambiguous. The court would go to no effort to resolve that ambiguity in favour of the former employer. The clause was found to be unenforceable.

The Ontario Court of Appeal, in *H.L. Staedler Company v. Allan*, [2008] O.J. No. 3048, has similarly held — by other reasoning — that non-competition agreements with employees are unenforceable except in exceptional circumstances. A non-solicitation covenant will almost always be considered a preferable way to protect a former employer.

In *Staedler*, two senior insurance sales employees departed suddenly and set up with a competing broker. The clause in issue included an undertaking that a terminated employee will not "conduct business with any clients or customers of H.L. Staedler Company Limited that were handled or serviced by you at the date of [your] termination" for two years.

The Court of Appeal concluded that non-competition clauses should only be enforced in exceptional circumstances. In almost every instance, a non-solicitation clause will better protect the employer's proprietary interest without unduly restricting the employee's ability to earn a livelihood.

In *Staedler*, the clause in issue was not interpreted as a non-solicitation covenant. It was read as a non-competition obligation that was not limited geographically, and applied to any business with clients or customers of the former employer. The Court of Appeal found the clause was not enforceable.

The foregoing recent appellate cases give credence to some employees' view that non-competition clauses are not worth the paper they're written on. If a departed employee sets up in competition, apparently in breach of a written non-competition covenant and the former employer seeks a remedy on an injunction motion or at trial, the employer will have to show why a non-solicitation covenant was not good enough, and that its non-competition language is unambiguous and reasonable. Alternatively, the employer will have to resort to an alternative analysis; for example, showing evidence of the use of the employer's confidential information by the departed employee. ■

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