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employment and labour relations group backgrounder

restrictive covenants

Businesses need to minimize the risk of ex-employees exploiting their trade relationships, confidential information, and market position. A common approach is to have new or current employees sign restrictive covenants—agreements that limit the employee's conduct. The three general forms of restrictive covenants are confidentiality agreements, non-solicitation agreements and non-competition agreements. In preparing employment agreements, employers should be aware of the following principles in order to ensure their employee restrictions will be upheld in court.

- Restrictive covenants are considered restraints on trade, but courts will allow them if they are reasonable between the parties and not contrary to public policy. (Shafron v. KRG Insurance Brokers (Western) Inc., 2009 SCC 6)
- A balance must be struck between open competition and the right of an employer to protect its confidential information and trade connections. (Mason v. Chem-Trend Limited Partnership, 2011 ONCA 344)
- The reasonableness of a covenant is determined by its geographic scope, duration, and extent of the activity being prohibited. Also, its terms must be unambiguous. (Shafron v. KRG Insurance Brokers (Western) Inc., 2009 SCC 6; Mason v. Chem-Trend Limited Partnership, 2011 ONCA 344)
- Employment contracts are more rigorously scrutinized than other commercial contracts because of the power imbalance between parties. (Shafron v. KRG Insurance Brokers (Western) Inc., 2009 SCC 6)
- Overly broad restrictive covenants will rarely be read down by courts to what might be reasonable; instead, the entire provision will be unenforceable. (*Shafron v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6)
- A covenant that precludes employees from doing business *of any sort* with an employer's customers or one that covers every customer is likely overly broad and must be narrowed to the employer's particular business and the customers the employee had dealings with. (*HL Staebler Company Limited v Allan*, 2008 ONCA 576; *Globex Foreign Exchange Corporation v. Kelcher*, 2011 ABCA 240; *Mason v. Chem-Trend Limited Partnership*, 2011 ONCA 344)

- The employee's position is a factor and a management and control position could justify a broader restriction. (*Mason v. Chem-Trend Limited Partnership*, 2011 ONCA 344)
- A court will generally not enforce a non-competition covenant where a non-solicitation covenant would adequately protect an employer's interest. (*Atlantic Business Interiors v. Hipson*, 2005 NSCA 16; *Valley First Financial Services Ltd. v. Trach*, 2004 BCCA 312)
- Current employees will not be bound by new covenants unless they are given something as consideration such as a raise or benefits. (*Techform Products Ltd. v. Wolda, 2001 CanLII 8604 (ON CA)*)
- When an employee is wrongfully dismissed, the employer cannot enforce restrictive covenants against that employee. (*Globex Foreign Exchange Corporation v. Kelcher*, 2011 ABCA 240 (CanLII) citing *Cohnstaedt v University of Regina* 1994 CanLII 4566 (SK CA; *Zesta Engineering Ltd. v. Cloutier*, 2010 ONSC 5810 (CanLII))
- Without restrictive covenants, employees are still under a duty of good faith and fidelity, but it is generally restricted to the period of employment. Post-employment duties are limited to not misusing confidential information or keeping customer lists. (*Globex Foreign Exchange Corporation v. Kelcher*, 2011 ABCA 240 (CanLII) at para. 25 citing ABCA, MBCA and SCC cases for three distinct principles)
- In Quebec, the enforceability of restrictive covenants is addressed in the *Civil Code of Quebec* ("CCQ"), which provides similar protection to the above common law principles relied on in other provinces. There are some notable differences, however, and employers should be alert that an employee agreement that is enforceable in one province may be unenforceable in Quebec. For instance, in Quebec if an employee is terminated "without a serious reason", the non-competition agreement is unenforceable.

A challenge for employers is attempting to use restrictive covenants in an increasingly global marketplace with worldwide clientele. This issue was recently addressed in *Mason v. Chem-Trend Limited Partnership*, 2011 ONCA 344 where Ontario's highest appeal court upheld a finding against a global company that its restrictive covenants were overly broad and therefore unenforceable. The company in that case has sought leave to appeal the decision to the Supreme Court of Canada. One of the main issues is whether worldwide restrictions would ever be found to be reasonable even if the company and its employees operate globally.

by Martin J. Thompson, Partner

a cautionary note

The foregoing does not constitute legal advice and the specific laws applicable to particular work or in a specific jurisdiction may be different. Any member of our Employment and Labour Relations Group would be pleased to discuss the impact of this law.

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