



You're gonna work for who?

Restricting departing employees depends on the contract

When employment and corporate relationships break down, concerns can arise about restrictive covenants, in which one party promises to refrain from certain actions.

Employers often put these covenants into employment agreements to limit employees' activity after the employee leaves. They're designed to protect client relationships and confidential information, as well as prevent former employees from competing in the same business, within a certain timeframe and area, and from soliciting the employer's employees, suppliers or customers.

They're also found in agreements between buyers and sellers. A buyer places restrictions on the seller from competing, taking away customers, or starting a competitive business.

In deciding whether to enforce restrictive covenants, courts consider competing principles in Common Law: freedom to earn a livelihood and freedom to contract. The court will try to balance the interests of the employer or buyer against the right of an employee or seller to earn a living.

The general rule is all restraints of trade are contrary to public policy and therefore void. But they can be justified, depending on public interest and other factors.

Anyone looking to enforce a contract must prove a restrictive covenant is reasonable. But the responsibility to show the covenant is against public interest lies with whoever doesn't want the covenant enforced.

As well, a restrictive covenant can't go beyond what's needed to protect an employee's interests, or anyone else seeking to uphold the covenant. To decide if a covenant is reasonable, we must ask some questions:

- Does the party relying on the restrictive covenant have a legitimate proprietary interest to protect?
- Is the restraint reasonable in terms of duration, geography and activities?
- Is the covenant against competition?

Different rules for different agreements

The law distinguishes between restrictive covenants in employment contracts and those in agreements for the sale of a business. Recently, Canadian courts have ruled restraints on former employees will be enforced less consistently than on sellers of busi-

nesses, which are generally enforced. This is especially true when a buyer of a business has paid for a restrictive covenant as part of the business.

This was shown in a BC case in which a defendant started working for the plaintiff to whom he also sold some business assets. The plaintiff made it clear a restrictive covenant was needed for the deal. Years later, the defendant stopped working for the plaintiff, opened his own competing business and did business in the geographic area covered by the restrictive covenant.

The judge said the enforceability depended on whether the restrictive covenant was in an employment contract or was part of the agreement to buy a business. Although the former clauses were void, the latter ones were valid. The defendant was therefore liable for the plaintiff's losses.

In another case, in Ontario, the plaintiff bought shares of the defendant's insurance brokerage and the defendant agreed to a four-year, non-competition covenant. After working for the plaintiff for a couple of years, the defendant resigned to work for a competitor. Some of the plaintiff's clients told the plaintiff to transfer their business to the competitor, and the plaintiff launched a breach of contract claim. The trial judge held the defendant breached the contract, since he did exactly what he had promised not to do. It didn't matter that the clients directed the transfer, or that they were friends and relatives of the defendant.

A restrictive covenant must also be clear, with the Supreme Court of Canada recently saying an ambiguous covenant would be unenforceable. In the court's eyes, it's up to whoever drafts the clause to make sure it's clear.

There can be other ways to enforce restrictive covenants with less risk, such as providing financial pros or cons to continuing the restricted activity. In one case, the plaintiff, a major shareholder, director and officer of the defendant, retired and sold his shares to the defendant. The defendant agreed to pay \$300,000, on condition the plaintiff continued as the defendant's fiduciary.

The plaintiff agreed to a five-year, non-competition clause. But before the clause ended, the plaintiff began working for the defendant's main competitor. When the defendant refused to pay the plaintiff's next annual instalment due under the agreement, the plaintiff launched an action. An appeal court held there was no inconsistency, and any restraint of trade in the agreement was reasonable.

This case shows another way to enforce restrictive covenants, giving anyone seeking to uphold a covenant an edge over the other party.

Enforcing restrictive covenants is risky. It requires a delicate balance between the competing interests of earning a livelihood and freedom of contract. To be enforceable, these covenants must be clear and unambiguous, and the restraint must be reasonable in terms of duration, geographic scope, and the nature of activities. These points can only be decided by considering the nature of the business and character of employment. As well, restrictive covenants should not go beyond what's needed to protect the interests of the party seeking to uphold them.

Anyone who takes these points to heart is in a better position to say to a court: take this agreement and enforce it.

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