

## Litigation - Canada

### Supreme Court defers to restrictive covenants negotiated by commercial parties

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#### Introduction

In a recent decision, the Supreme Court upheld the validity of restrictive covenants contained in a commercial agreement for the sale of a business against a vendor who had become an employee of the purchaser after the sale. The decision indicates that where restrictive covenants are linked to a commercial agreement for the sale of a business, rather than an employment agreement subsequently concluded between the vendor and purchaser, courts will show deference to the commercial bargain struck by the vendor and purchaser.

#### Facts

In *Payette v Guay inc* Guay inc, a crane rental company, acquired assets belonging to several companies in the crane rental business controlled by Yannick Payette and his business partner for C\$26 million. In accordance with the purchase and sale agreement, Payette worked full time as consultant for Guay for a period of six months following the close of the transaction to ensure a smooth transition. As contemplated under the agreement, Payette and Guay entered a separate employment agreement at the end of the consulting term, which was renewed for an indefinite term. Shortly after the renewal, Guay terminated Payette without cause.

The purchase and sale agreement contained non-compete and non-solicit clauses. The non-compete clause prohibited Payette from directly or indirectly participating in the crane rental industry in the province of Quebec for a period of five years from the date that he ceased to be employed by Guay. Under the non-solicit clause, Payette agreed that he would be prohibited from soliciting his former customers and customers of Guay for the same period. The non-solicit clause contained no territorial limits.

Seven months after his termination, Payette started a new job in Quebec as operations manager for a competitor of Guay. Guay commenced proceedings for an injunction restraining Payette from breaching the restrictive covenants and obtained an interlocutory injunction. However, the Quebec Superior Court dismissed Guay's proceeding at trial. The Quebec Court of Appeal overturned the trial decision and ordered a permanent injunction against Payette, which was affirmed by the Supreme Court.

#### Supreme Court decision

In its decision the Supreme Court stated that the rules governing the interpretation of restrictive covenants regarding employment and competition differ based on whether they arise in a commercial or an employment context. The rules that apply in an employment context are stricter because of the imbalance of bargaining power that generally characterises an employer-employee relationship, and the need to protect the employee in such circumstances. In contrast, the rules that apply in a commercial context are more generous as there is ordinarily no imbalance of power between a vendor and purchaser, especially where the evidence shows that the parties negotiated on equal terms and received advice from competent professionals. In such a commercial context, flexibility is required to protect freedom of trade and promote stability of commercial agreements. Thus, while the onus falls on an employer to establish that restrictive covenants owed by its employee are reasonable, in the commercial context the onus falls on the vendor to establish that such covenants are unreasonable.

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To determine whether a restrictive covenant is tied to a contract of sale of assets or a subsequent contract of employment, it is important to identify why the parties entered into the covenant. This is done by considering the language and context of the agreement. The court concluded that the reasons that Payette entered into the restrictive covenants were linked to the sale of his business to Guay, not his post-sale duties to Guay as an employee. The court noted that the agreement stated that the restrictive covenants were "in consideration of the sale" of assets. Further, the court stated that the main point of the transaction was for Guay to acquire the vendor's goodwill, skilled employees and customers, and that the transaction would never have taken place if Guay had not obtained the protection provided by the restrictive covenants. Non-compete and non-solicit clauses are included in commercial contracts for the sale of assets to protect the purchaser's investment by enabling the purchaser to build strong client ties without fearing competition from the vendor. Accordingly, the more generous commercial rules applied to the restrictive covenants in question.

Noting that Payette had failed to discharge his burden to prove that the restrictive covenants were unreasonable, the court ruled that the non-compete clause was lawful as there was no evidence that:

- the five-year term was unreasonable given the highly specialised nature of the crane rental business; or
- the territorial scope of Quebec was overly broad, given that Payette's business had been conducted throughout Quebec (although the vast majority was based in Montreal) and the mobile nature of the crane rental business.

The court also found that the non-solicit clause was reasonable and did not require a territorial limitation, since such a limitation can easily be identified by analysing the target customers. Significantly, the court noted that in the context of a modern economy, customers are no longer limited geographically, and that as a result, territorial limitations in non-solicit clauses have generally become obsolete.

## Comment

*Payette* provides comfort and predictability to purchasers of businesses that have negotiated, and relied on, restrictive covenants on employment and competition to protect their investments. Provided that such restrictive covenants are clearly linked to the contract of sale of a business (as opposed to a subsequent employment contract between the vendor and purchaser), courts can be expected to adopt a deferential approach to the balance that commercial parties strike between protecting the purchaser's legitimate business interests and free trade. Solicitors acting on behalf of such purchasers should ensure that the agreement of sale is drafted to make clear that the restrictive covenant is accepted by the vendor in exchange for the consideration it received on the sale of its business.

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