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Spring Employment and Labour Law Seminar

To Compete or Not to Compete: Tips and Traps When Drafting Restrictive Covenants

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June 10, 2016

Agenda

- Context: What is the playing field?
- The Key Considerations when Drafting Restrictive Covenants
- Recent Case Law

Context

- Who is it that needs a non-competition or non-solicitation covenant?
  - Need to demonstrate “legitimate proprietary interest”
- What is the “legitimate proprietary interest” – senior management vs. employee with customer relationships
- Transaction versus employment:
  - Relative Bargaining Power and Equality of Bargaining Position
  - Freedom of Contract vs. Restraint of Trade

Payette v. Guay Inc. [2013] 2013 SCC 45

- Asset transaction
- **APS** had restrictive covenants for principal of business
- Key employee/principal was retained as “consultant”, and subsequently became an employee
- Employment terminated without serious reason, and he started to compete, claiming the restrictive covenants were void

Payette v. Guay Inc. [2013] 2013 SCC 45

- If the covenants were entered into in context of employment, they would be void, since employer dismissed without “serious reason” (Civil Code)
- Supreme Court held that, viewed in context, the covenants were part of the sale, not the employment contract:
  - The covenants appeared in the APS, NOT in the employment contracts
  - The “consideration” for the restrictive covenants was **stated** to be the sale, not the employment relationship
  - The references in the covenants to the “end of employment” simply indicated when the covenants were to take effect
- PRACTICE POINT: Put sale-related covenants directly in the APS, not in the employment contracts, even if they are effective only at the end of employment

Payette v. Guay Inc. [2013] 2013 SCC 45

Reasonableness

SCC:

- In employment context, onus is on the employer to prove reasonableness
- In commercial context, onus is on the vendor to prove provisions are *unreasonable*
- Criteria for assessing reasonableness are “less demanding” in commercial context; basis for upholding covenants is much broader
- Factors:
  - Sale price
  - Nature of business’ activities
  - Parties’ experience and expertise
  - Fact that the parties had access to legal counsel and other professionals
  - Any other circumstances

Payette v. Guay Inc. [2013] 2013 SCC 45

Restrictive covenants were subject of lengthy negotiations, between experienced business people with professional advisors; no imbalance of power

1. Non-compete: five years from date he ceased to be employed with the purchaser, in any business operating in the crane rental industry within the territory of Quebec

Reasonable:

- Duration and business were not problematic
- Territory gave pause since majority of business was only in Montreal, but recognizing the “mobility” of the crane rental business, it was upheld

Payette v. Guay Inc. [2013] 2013 SCC 45

2. Non-solicit: for five years from date he ceased to be employed with the purchaser, not to solicit and not to do business or attempt to do business with any of the customers of the Business, or solicit or hire any of the employees, officers, executives or other persons working for the business

On reasonableness, primary issues were:

- Did language “do business or attempt to do business with” create a hybrid clause, requiring territorial restriction?
- Lack of Territory was not problematic, since context of negotiations made clear that interpretation was not that words were used to create non-compete obligation

Payette v. Guay Inc. [2013] 2013 SCC 45

- Non-solicit therefore did not require a territorial restriction:

"…a territorial limitation is not absolutely necessary for a non-solicitation clause applying to all or some of the vendor's customers to be valid, since such a limitation can easily be identified by analyzing the target customers"

"… In the modern economy, customers are no longer limited geographically, which means that territorial limitations in non-solicitation clauses have generally become obsolete"

- Since the parties negotiated two separate clauses, one non-compete and one non-solicit, clear they intended the latter to be a more narrow restriction, and not a non-compete

The key considerations when drafting restrictive covenants

- The clause must be reasonable and go no further than necessary
- The clause must protect a legitimate proprietary interest
- The clause must be clear

Reasonableness

- Geographic Scope
  - Non-Competition Covenants vs. Non-Solicitation Covenants
  - Where do you do business?
  - Where does the business unit that the employee works in do business?
  - What territory does the employee serve?
- Temporal Scope
- Business Scope
  - Business of the “company and its affiliates” vs. business unit the employee works in

Reasonableness

- Business Scope
- Any person who was a customer:
  - “at any time during the employee’s employment” vs.
  - “in the last year”
  - “of the Company” vs.
  - “with whom the employee dealt”

Legitimate proprietary interest

- No property in “potential customers”, EXCEPT “recent pitches”
- Client relationships
- Client preferences
- Senior executives: key strategic knowledge

The clause must be clear

- Clear Definitions
  - “Business”: “any business the Company engages in”
  - “Activities”
  - Geographic territory: “any territory the company or its affiliates conducts business”; “the Metropolitan City of Vancouver”
- “No Deal Clauses”
- “Blue-Pencil” and Notional Severance

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Recent Case Law

Computer Enhancement v. J.C. Options, et al, 2016 ONSC 452

- court order prohibited the defendants from soliciting work from any person with whom they had done business for the plaintiff
- The defendants responded to a public RFP issued by a person with whom they had done business for the plaintiff

ISSUE: Was that response in breach of the non-solicit?

Recent Case Law

Computer Enhancement v. J.C. Options, et al, 2016 ONSC 452

- The court recognized that "a bid submitted in response to a public tender is not a solicitation", and that "responding to a request for proposals is not sufficient" to establish a breach of a non-solicitation obligation.
- Important element is that the request for the proposal must come from the **client** without any solicitation for that RFP from the entity subject to the non-solicit.
- Non-solicits generally will not preclude responses to publicly issued RFPs – need a non-compete for that.

Recent Case Law

Enerflow Industries Inc. v Surefire Industries Ltd., 2013 ABQB 196

- Clause sought to be enforced:

  "Employee hereby agrees not to…directly or indirectly compete with the business of the Company and its successors and assigns during the period of employment and for a period of two years following termination of employment"

  "The term "not compete" as used herein shall mean that the Employee shall not own, manage, operate, consult or to be employee [sic] in a business **substantially similar to or competitive with** the present business of the Company or such other business activity in which the Company may substantially engage during the term of employment"

Recent Case Law

Enerflow Industries Inc. v Surefire Industries Ltd., 2013 ABQB 196

- Non-compete provision has no geographic restriction, and cannot be "read down" to incorporate geographic restriction
- Definition of "not compete" is also overly broad, because it prohibits employee from being engaged in a business "similar to" that engaged in by the Employer
- Therefore non-compete is void

Recent Case Law

MEDIchair LP v. DME Medequip Inc., 2016 ONCA 168

- Non-compete is ***not*** overly broad in its prohibition of engaging in a business "similar to" that engaged in by the franchisor:

  "…similarity is found by comparing not only the product line, but also the method of operation, including whether the appellant was trading on the goodwill of the MEDIchair operation from which it had benefitted over the years."

- BUT: Non-compete fails because the franchisor had no "legitimate business interest" in enforcing the non-compete, since it had decided not to open another location that market

Recent Case Law

ThyssenKrupp Elevator (Canada) Limited v. Amos, 2014 ONSC 3910

- Employee was sales representative, and entered into both non-compete and non-solicit obligations
- Non-compete clause sought to be enforced:

  "Amos shall not, during the term of his employment hereunder and for a period of one (1) year from its termination…carry on or be engaged in, or concerned with or interested in, in any capacity whatsoever (including that of principal, agent, shareholder, employee, lender or surety) any person…engaged in or concerned with or interested in, the conception, designing…or sale of products or services similar to those conceived…or sold by the Corporation in the course of his employment with the Corporation, within the Province of Ontario."

Recent Case Law

ThyssenKrupp Elevator (Canada) Limited v. Amos, 2014 ONSC 3910

- Non-compete was too broad:
  - Would prohibit him from even holding shares or lending money – no legitimate interest protected
  - Province-wide was too broad, considering he was based in, and focused on, London Ontario

Recent Case Law

ThyssenKrupp Elevator (Canada) Limited v. Amos, 2014 ONSC 3910

- Non-solicit clause sought to be enforced:

  "Amos shall not, during the term of his employment hereunder and for a period of one (1) year from its termination…solicit or attempt to solicit, interfere with or endeavour to entice away any business, client, prospective client or contract of the Corporation then existing or contemplated by the Corporation within 12 months prior to the termination of Amos."

Recent Case Law

ThyssenKrupp Elevator (Canada) Limited v. Amos, 2014 ONSC 3910

- Non-solicit unenforceable:
  - Non-solicits less objectionable generally, but still must be reasonable
  - Prohibition on solicitation of “any business, client, prospective client or contract of the Corporation then existing or contemplated by the Corporation within 12 months prior to the termination” was too broad:
    - Corporation operates throughout Canada; no way for Amos to know what business was being contemplated anywhere in the country
    - No way for him to know what “prospective clients” might be being contemplated
    - Not only ambiguous, but impossible for Amos to know who he was precluded from soliciting

Recent Case Law

Ford v. Keegan, 2014 ONSC 4989

- Non-solicit clause sought to be enforced:

  "The Corporation and Frank Keegan agree not to, for a period of two years from the date this Agreement is terminated, directly or indirectly…solicit, induce or attempt to solicit away from Training Service the business of any customer of Training Service or otherwise engage or conduct business with any customer of Training Service…

  The definition of customer includes any existing customer of Training Service, any entity which Training Services has done business with in the two years prior to the termination of this Agreement, or any prospective customer to whom a proposal has been sent, in the two years prior to the termination of this agreement, or discussions have been had with respect to the provision of services."

Recent Case Law

Ford v. Keegan, 2014 ONSC 4989

- Non-solicit unenforceable:
  - Keegan did not have access to the master list of all Training Services' customers, and therefore including "any company to whom a proposal had been made or discussed", left Keegan unable to know which of his potential customers were off-limits to him.
  - Prohibition against soliciting an entity that "could have been a customer" was ambiguous and overly broad, as it effectively prohibited Keegan from competing.
  - Invalid and unenforceable; Court will not re-write a covenant

Alternatives to Non-Competes

Levinsky v. TD Bank 2013 ONSC 5657

- Long Term Compensation Plan: awards under the Plan matured and became payable three years after the grant date
- Plan provided that the award was forfeited in full if the participant resigned prior to the maturity date
- Levinsky had participated in the Plan for eight years
- Resigned and forfeited 3 years' worth of grants
- Claimed:

  (1) the clause was unconscionable; and

  (2) it was in restraint of trade, and was an unlawful non-competition clause.

Levinsky v. TD Bank 2013 ONSC 5657

- Court found that the Plan was not unconscionable:
  - Levinsky was fully aware of the terms of the Plan (he had signed annual acknowledgements confirming his receipt and understanding of the Plan);
  - he was a sophisticated and well-educated individual;
  - he had received significant benefits as a result of his participation in the Plan over the years; and
  - he had made no complaints about the terms of the Plan while he was employed.
- The Bank relied heavily on the Plan provisions, which stated that the purpose of the Plan was to retain highly qualified executives who would contribute to the long-term success of the business

Levinsky v. TD Bank 2013 ONSC 5657

- Court conducted thorough analysis of the “restraint of trade” argument, and put forward the following general principles:
  - Entitlement to incentive compensation is governed by the terms of the contract.
  - If entitlement depends on continued employment and does not tie eligibility to the type of work done after employment ends, the clause is not a restraint of trade, but simply a condition of entitlement “designed to secure the employee’s loyalty”.
  - If the deferred compensation has already vested, a forfeiture provision could be a restraint of trade if the forfeiture occurs because the employee competes after employment ends, rather than being based simply on the fact that the employee is no longer employed.
- Focus: whether the clause tied the forfeiture of compensation to the end of employment, or whether the forfeiture was based on the former employee’s post-employment competitive activities.

Levinsky v. TD Bank 2013 ONSC 5657

- Deferred compensation plans should clearly state:
  - the rationale for providing deferred compensation (encourage loyalty and retention);
  - that awards remain unvested until the maturity date; and
  - what conditions attach to the vesting – is any forfeiture based solely continued employment, or is it based on the nature of the employee's post-employment activities (i.e. post-employment competition).
- Plan provisions must be clearly brought to the employee's attention during employment. If any employees object to the Plan provisions during their employment, the employer should proactively respond to such objections, to avoid a claim later that the disputed provisions were not agreed to.

Alternatives to Non-Competes

Rhebergen v. Creston Veterinary Clinic Ltd., 2014 BCCA 97

- Clause: If employee competes within 25-mile radius within three years, must repay lost training costs/lost value to business, with declining amount each year ($150,000; $120,000 and $90,000)
- Calculated with reference to investment employer made in hiring, mentoring, training and equipment, and volume of business lost if she competed

Rhebergen v. Creston Veterinary Clinic Ltd., 2014 BCCA 97

- Court:
  - It is restraint of trade, since it seeks to impose burden for engaging in post-employment competition – effect over form
  - No penalty, since genuine estimate of loss due to competition
  - Clause reasonable, since genuinely attempted to compensate for losses due to competition
  - Clause clearly drafted: "set up a veterinary practice" is not ambiguous, but rather is clear – she cannot conduct a practice within the prescribed territory (overturns lower court on this point)
  - Therefore enforceable

Thank you

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