PURCHASER IN THE DRIVER'S SEAT: ONTARIO COURT OF APPEAL ENFORCES COMMERCIAL NON-COMPETE

Posted on July 9, 2024

Categories: Insights, Publications

In a recent decision, *Dr. C. Sims Dentistry Professional Corporation v Cooke* [***Sims***][1] the Ontario Court of Appeal ("**ONCA**") upheld a non-compete clause in the context of the purchase and sale of a business. Following the sale of a dental practice between two dentists, the ONCA agreed with the purchaser's position that the non-competition clause was enforceable against the seller to protect the value of the dental practice.

Background

Pursuant to a share purchase agreement ("**SPA**"), Dr. Sims (the "**Purchaser**"), purchased all of the shares of the Hamilton dentistry practice of Dr. Cooke (the "**Seller**") for $1.1 million in 2017.

As part of the SPA, the Seller agreed to work in the dentistry practice for at least 2 years (subject to notice of termination) and agreed to a non-competition provision in favour of the Purchaser. The non-competition provision prohibited the Seller from directly or indirectly engaging in the practice of dentistry, or permitting his name to be used in such a practice, for 5 years following his association with the practice within a 15 km radius (the "**Non-Compete Covenant**").

About 2.5 years after the sale, the Purchaser terminated his association with the Seller with the required notice in the SPA.

A few months later, the Seller communicated to the Purchaser that he intended to work at another dental practice 3.3 km away, and took the position that the Non-Compete Covenant was unenforceable. Once the Seller began working at the competing dental practice, the Purchaser commenced an action and received an interlocutory injunction.

The Decision

The ONCA held that the Non-Compete Covenant was reasonable and enforceable in the commercial context of this case.

The ONCA agreed with the trial judge in citing an earlier Supreme Court of Canada ("**SCC**") decision, *Payette v*

Guay inc. [**Payette**] where the SCC ruled: "[i]n a commercial context, the restrictive covenant is deemed to be lawful unless it can be shown to be unreasonable"[2]. In contrast, in the employment context, Courts will apply more scrutiny[3] and will often find non-competition covenants overbroad and unenforceable.

In *Payette*, the SCC referred to the "cardinal rule" that parties negotiating the sale of assets have greater freedom of contract than parties negotiating a contract of employment, and that the common law rules of restrictive covenants relating to employment do not apply with the same rigour in the context of a commercial contract, particularly when the parties negotiated on equal terms and were advised by competent professionals.[4]

Further, the ONCA reiterated a key principle from other SCC decisions that restrictive covenants in commercial transactions are intended to protect a purchaser's interest in the goodwill of the acquired business.[5] Otherwise, if a seller cannot assure a purchaser that it will not later compete with the purchaser, the seller might find itself unable to sell its business.[6]

In this decision, the Seller provided the Purchaser with a professional valuation, which valued the goodwill of the dentistry practice at $741,455 while factoring in an anticipated 5-year restrictive covenant covering a reasonable radius. As such, the valuator estimated the value of the dental practice as conditional on not only an association between the Seller and Purchaser to transition the dental practice, but also an agreement by the Seller not to practice dentistry for 5 years within a reasonable radius.

Even more, the ONCA agreed with the trial judge's assessment that the 5-year period restrictive period was reasonable for a dental practice, where it takes several visits for patients to build a trusting relationship with their dentist, particularly if patients only visit a dentist annually.[7] The 15 km radius was also reasonable as it reflected how far customers might travel to access services, and was appropriate in other cases involving dental practices.[8] As such, the trial judge rightly recognized the need to protect the Purchaser's business interests.

Takeaways for Businesses and Employers

In the commercial context, businesses should be relieved that there is a well-established presumption of enforceability of non-competition covenants to protect the value of a purchaser's business interests. At the same time, non-competition covenants should still be properly drafted and reasonable in the circumstances, as it is rare that a Court will "blue pencil" an overbroad commercial covenant to make it enforceable.

Further, the business rationale for selecting a particular geographic scope, duration, and services covered in a non-competition covenant must be sound, as it will become evidence scrutinized in a dispute. Such evidence may include past practice of a particular industry and seller, the parties' intentions and communications,

customer/client behaviour, and professional opinions and valuations.

Businesses should also ensure that each party to a commercial transaction has equal bargaining power and is represented by legal counsel and other professionals.

In the employment context, however, the same presumption of enforceability does *not* apply, as Courts will often view an employee as less powerful than an employer. Employers must ensure to seek individualized legal advice, particularly in Ontario where non-competition agreements entered into on or after October 25, 2021 are largely illegal except for specific executives or when arising out of a sale of business. Often, properly drafted non-solicitation clauses will meet an employer's legitimate business needs and have much greater chances of enforceability than non-competition clauses.

[1] 2024 ONCA 388.
[2] 2013 SCC 45 at para 58.
[3] *MEDIchair LP v DME Medequip Inc.*, 2016 ONCA 168 (CanLII) at para 33 and *Kerzner v American Iron & Metal Company Inc.*, 2018 ONCA 989 (CanLII) at para 56.
[4] Payette at paras 38-39.
[5] *Shafron v KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6 (CanLII) at para 23 and *Elsley v J.G. Collins Ins. Agencies*, 1978 CanLII 7 (SCC) [*Elsley*] at page 924.
[6] *Elsley* at page 924.
[7] *Sims* at para 18.
[8] *Sims* at para 23.

By Ioana Pantis

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.