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More Restrictions on Restrictive Covenants
The SCC's Decision in *Shafron v. KRG Insurance Brokers (Western)*

As many employers are well aware, restrictive covenants are difficult to enforce in Canada. Unfortunately, the Supreme Court of Canada's (the "SCC") recent decision in *Shafron v. KRG Insurance Brokers (Western*), 2009 SCC 6 *("Shafron")* has not made enforcement of such contractual commitments any easier.

Rather, this case emphasizes once again that restrictive covenants (which include non-competition and non-solicitation provisions) are generally contrary to public policy as "restraints of trade". Therefore, only "reasonable" restrictive covenants may be enforced. In assessing reasonableness, relevant considerations include the geographic scope of the term, the duration of the restrictions, and the range of prohibited activities.

In *Shafron*, the Court also makes it clear that an ambiguous restrictive covenant will never be considered reasonable. Further, this case delivers a clear message to employers that they cannot rely on courts to fix restrictive covenants that are not drafted appropriately.

The Facts – In Brief

Morley Shafron sold his shares in his insurance business to KRG Insurance Brokers Inc. in December 1987 for $700,000. Shafron continued his employment with the business, which was renamed KRG Insurance Brokers (Western) Inc. ("KRG"), following the sale. In early 1988, Shafron signed an employment contract with KRG that included a provision restricting his ability to compete in the insurance brokerage business in the "Metropolitan City of Vancouver" for three years after leaving his employment with KRG, unless his employment was terminated by KRG without cause.

Shafron continued to work for KRG for approximately 13 years after selling the business, pursuant to a series of employment contracts which all contained substantially the same non-competition provision. During this period KRG was sold once again, but Shafron did not receive any payment for goodwill in connection with this second sale of the business.

Shafron left his employment with KRG in December 2000, and commenced employment with another insurance company in Richmond, British Columbia in January 2001. Understandably, KRG brought an action against Shafron for breach of contract (among other claims).

The SCC's Decision

The SCC decided that it was appropriate to consider the restrictive covenants in this case in the context of an employment relationship, rather than in the context of a sale of business. The Court reasoned that the relevant employment contract was signed by Shafron approximately 11 years after the sale of his business, and further, Shafron did not receive any payment for goodwill when the business was sold a second time during his employment with KRG. This point is significant because restrictive covenants in employment contracts are subject to closer scrutiny, in part, because of the imbalance of power between the parties.

Upon examining the restrictive covenant itself, the Court found that the geographic scope of the provision was ambiguous since the term "Metropolitan City of Vancouver" has no legal definition or fixed recognized meaning. The Court clearly stated that a restrictive covenant which is ambiguous as to time, activity or geography cannot be shown to be reasonable (unless the ambiguity can be resolved). As restrictive covenants are presumed to be unenforceable, unless they are shown to be reasonable, this means that ambiguous restrictive covenants will not be enforced.

The Court considered (and rejected) three legal concepts which could have potentially been applied to fix the restrictive covenant in Shafron's employment contract, as follows:

1. "Notional severance", which involves reading down a contractual provision in order to make it legal and enforceable, was completely rejected by the Court as having no place in the construction of restrictive covenants in employment contracts.

2. "Blue-pencil severance", which involves removing part of the contractual provision so that the remaining portion is legal and enforceable, was also found to be inappropriate in this case. The Court accepted that this form of severance may be appropriate in rare cases, if the part of the provision that is removed is clearly severable, trivial and not part of the main purport of the restrictive covenant. However, this form of severance will only be applied in cases where the parties would have unquestionably agreed upon the change to the agreement without varying any other terms of the contract or otherwise changing the bargain. The Court found that there was no evidence this was the case in *Shafron*.

3. Rectification, which involves correcting an error in a written agreement where the document is inconsistent with a prior oral agreement between the parties, was also inapplicable in this case. The Court found no evidence that the parties had a prior agreement respecting the geographic scope of the restrictive covenant and merely made a mistake in the written document.

Therefore, the Court found that the ambiguity in the term "Metropolitan City of Vancouver" could not be resolved, and therefore, the non-competition provision was unreasonable and unenforceable.

Practical Implications

It is not uncommon for an employer to want restrictive covenants in its employment contracts, in order to protect the company's business interests. *Shafron* does not preclude employers from utilizing such protections. However, the SCC has sent a clear message to employers that the courts will not assist them to enforce overly broad or ambiguous restrictive covenants.

Employers must recognize that there are some limits upon parties' freedom to contract. It is better to have a clear and narrowly defined restrictive covenant that may be upheld, as opposed to broad general restrictions that are likely to be unenforceable. For instance, non-competition covenants will rarely be enforced by courts, however, a reasonable non-solicitation covenant together with a confidentiality clause may provide an effective alternative. For further discussion on this point, see McMillan LLP's prior bulletin "Non-Competition Agreement - Not worth the paper it's written on?" (September 2008).

Therefore, employers would be well advised to consider what they truly need to protect their business interests at the outset of their employment relationships. By considering the nature and level of each individual employee's position, an employer can carefully tailor the scope of a restrictive covenant so that it is more likely to be upheld as reasonable. Further, in light of *Shafron*, it is vitally important for employers to ensure that restrictive covenants in their employment contracts are unambiguous.

Qualified legal counsel should be consulted to ensure that restrictive covenants are drafted appropriately, to maximize the potential for enforceability of such important contractual terms.

Written by Lyndsay Wasser

A Cautionary Note

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

About McMillan's Employment and Labour Relations Group

The members of the Employment and Labour Relations Group have the expertise and experience to deal efficiently and effectively with all matters arising out of employment and labour law, as well as planning for legislative changes, structuring of business activities, and any other related matters.

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