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NON-COMPETITION AGREEMENTS IN CANADA

ON LIFE SUPPORT BUT NOT DEAD!

WHEN AN employee leaves employment, the former employer will often want to restrict the departing employee's ability to use the knowledge, know-how and insight gained in the course of that employment, to the benefit of a competitor. Historically, a non-competition agreement might have achieved this end. However, the law has evolved and a recent amendment to Ontario's Employment Standards Act, 2000 ("ESA") (for example) has called into question the utility and effectiveness of a non-competition agreement.

This article explores the factors a court will consider when deciding whether to enforce a non-competition agreement, the impact of recent legislation, and key takeaways for an employer that wants to limit a former employee's ability to compete post-employment.

Enforcement of a Non-Competition Agreement – Generally

At its simplest, a non-competition agreement prohibits a former employee from working for a competitor for a defined period. It is more restrictive than a non-solicitation agreement which restricts the employee from soliciting the former employer's customers or employees for a period, but does not limit the employee's ability to accept work with a competitor.

Courts are generally reluctant to enforce a non-competition agreement in the employment context because these agreements are viewed as a restraint on trade and, often, an overly restrictive attempt to safeguard a legitimate business interest. By contrast, a non-competition agreement entered into as part of a commercial transaction, such as a sale of business, is more likely to be enforced, because the vendor receives consideration tied to the value of the business, which value could be significantly undermined if the vendor competes immediately post-sale.

When evaluating a non-competition agreement in the employment context, a court will consider three factors:

1. **Does the employer have a proprietary interest entitled to protection?** Does the employee have information or knowledge of a proprietary nature that could damage the business if known to a competitor?

2. **Are the temporal and spatial features of the agreement too broad?** The length of time a non-competition agreement will apply should be as short as necessary to protect the former employer's legitimate interests. It is generally accepted (there are exceptions) that proprietary information will be less accurate and of diminishing value over time.

   The geographic scope of a non-competition agreement should be narrowly and accurately drafted to apply only to those jurisdictions in which the employee's knowledge could do damage to the former employer's business. For example, the employee should not be restricted from competing in "North America" if the former employer does not do business in the Caribbean and/or Mexico.

3. **Is the agreement unenforceable for being against competition, generally?** A non-competition agreement should be drafted narrowly to only restrict employees competing in a role and in a business that directly competes with the former employer. The agreement should not restrict an employee from accepting any position with a competitor; only a position in which their knowledge of the former employer's business could be used to compete.

   An employer should also evaluate if a less restrictive agreement (such as a non-solicitation and/or confidentiality agreement) could achieve the employer's objective. For example, if the goal is to restrict the former employee from poaching a former employer's clients, a non-solicitation clause might suffice.

Careful drafting of a non-competition agreement is critical, as Canadian courts will not apply the "blue pencil" doctrine applied in the United States to rewrite an otherwise unenforceable agreement. As explained in a 2009 decision by the Supreme Court of Canada[1]:

> Employers should not be invited to draft overly broad restrictive covenants with the prospect that the court will sever the unreasonable parts or read down the covenant to what the courts consider reasonable. This would change the risks assumed by the parties and inappropriately increase the risk that an employee will be forced to abide by an unreasonable covenant.

Ontario's New Restriction on Non-Competition Agreements

Effective December 2, 2021, the ESA was amended to expressly prohibit an employer and employee from entering into a non-competition agreement, subject to certain prescribed exceptions, discussed below. This prohibition applies retroactively to October 25, 2021 (the date the amendment was first introduced) but does not apply to a non-competition agreement entered into prior to October 25, 2021. A non-competition agreement entered into in violation of the ESA is void.

The ESA defines a non-competition agreement (called a "non-compete" agreement in the legislation) as "an agreement, or any part of an agreement, between an employer and an employee that prohibits the employee from engaging in any business, work, occupation, profession, project or other activity that is in competition with the employer's business after the employment relationship between the employee and the employer ends".

Despite the general prohibition on a non-competition agreement, there are two notable exceptions under the ESA that, in many respects, mirror the circumstances in which a non-competition agreement is more likely to be enforced by the courts.

First, the prohibition does not apply if the agreement is entered into with an employee who is an executive, because an executive is generally considered sophisticated and with equal bargaining power, and is more likely, in their role, to have information and know-how that could be damaging if used by a competitor. An executive is defined as "any person who holds the office of chief executive officer, president, chief administrative officer, chief operating officer, chief financial officer, chief information officer, chief legal officer, chief human resources officer or chief corporate development officer, or holds any other chief executive position".

Second, the prohibition does not apply if the non-competition agreement is entered into as part of a sale of a business (which includes a lease), or part of a business, if the purchaser and seller agree that the seller is prohibited from engaging in competitive activity after the sale and, immediately after the sale, the seller becomes an employee of the purchaser.

Key Takeaways for Employers

Although courts and legislators are increasingly striking down non-competition agreements for the reasons described above, there is a time and a place for their proper use. In other words, non-competition agreements may be on life-support, but they are certainly not dead.

If there may be utility in having a non-competition agreement with select employees, an employer should:

- Satisfy itself the agreement is permissible under applicable provincial, federal or territorial law.
- Critically evaluate if a lesser restrictive covenant, such as a non-solicitation agreement or confidentiality agreement, would suffice to protect business interests.
- Ensure the non-competition agreement is drafted accurately and appropriately narrowly, both in temporal and spatial scope, and is tied to the nature of the businesses and role(s) in which the employee cannot compete.

[1] KRG Insurance Brokers v. Shafron, 2009 SCC 6

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