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SUPREME COURT OVERTURNS BC COURT OF APPEAL'S RULING ON COMPETITION BY EX-EMPLOYEE

By Lisa Goodfellow, Partner of Fraser Milner Casgrain LLP, Employment and Labour Group. Reproduced with Permission.

The Supreme Court of Canada released a decision on January 23, 2009 providing the latest guidance on restrictive covenants, the case of *Shafron v. KRG Insurance Brokers (Western) Inc.*¹ Mr. Shafron sold his insurance brokerage business to KRG in 1987. No restrictive covenant was contained in the sale documents, but he entered into a series of employment agreements with KRG afterwards, in which he agreed not to compete with KRG for 3 years following the end of his employment for any reason except a without cause termination, anywhere in the "Metropolitan City of Vancouver". Several years later, KRG was sold via shares to a new owner, and Mr. Shafron continued to work for KRG under further employment agreements, all of which contained a similar non-compete. He then left KRG to work for an insurance brokerage in Richmond, BC, and KRG sought to enforce the covenant, also alleging breach of fiduciary duty and confidentiality.

The trial judge found that he was not a fiduciary of KRG, and that he had not breached his duty of confidentiality. On the restrictive covenant, it held that the geographic scope of "Metropolitan City of Vancouver" was ambiguous, as there was no such legal municipal entity. Thus, the covenant was void for ambiguity and not enforceable. The British Columbia Court of Appeal ("BCCA") overturned this latter part of the decision, purporting to use notional severance to interpret the "Metropolitan City of Vancouver" to mean the City of Vancouver, the UBC Endowment Lands, Richmond and Burnaby. It held that scope (and the 3-year time frame) to be reasonable and enforceable and, thus, found Mr. Shafron to be in breach of the restrictive covenant.

Inside

Progress of Legislation	
Federal Budget legislation introduced	2
Alberta introduces reservist leave	3
Manitoba's child and foreign worker protection legislation	4
Changes to N.W.T. Human Rights Commission	4
Yukon Minimum Wage Reminder	
Recent Cases	
Maternity leave employee not promoted	5
Team leader wins overtime pay	5
Reinstatement of employee with poor attitude	6
No abandonment by union found	6
First Nations agency in provincial domain	7
Termination to avoid paying pension	7
Imprisoned EI recipient received benefits	8

The SCC overturned the decision of the BCCA, stating that an ambiguous restrictive covenant can never be enforceable. The geographic scope could not be blue-pencilled, as the word Metropolitan was not a stand-alone term that could be deleted without changing the meaning of the rest of the clause.

Notional severance involves reading down an illegal provision in order to make it legal and enforceable. The SCC said that notional severance can only be used in the rarest of cases, where there is a “bright line test” for what is legal or reasonable. In restrictive covenants, however, there is no clear guideline for what is legal and enforceable. Further, to read down the scope to what the court considers reasonable is to re-write the contract between the parties, which the courts should never do. That would invite employers to draft overly-broad restrictions in reliance that the court would read it down to the broadest scope that it considered reasonable. The SCC stated that the real sanction behind a restrictive covenant is the “terror and expense” of litigation, which gives the employer a great advantage over the employee. It is best that the employer have the onus of ensuring that the clause is reasonable as written.

KRG also asked the court to rectify the contract in the alternative. The SCC held that it could not apply the doctrine of rectification, which is used only when there is evidence that both parties agreed to a term, but there was an error in writing it down. Here, there was no clear evidence of what either party intended “Metropolitan City of Vancouver” to mean, let alone a common intention, and no evidence that there had been an error in reducing their agreement to writing.

The SCC also confirmed the long-standing and important distinction between restrictive covenants in the context of a sale of a business and in an employment contract. The courts will give far more rigorous scrutiny to those in the employment context than in the sale of a business, where there is no sale of goodwill, and generally no compensation to the employee for agreeing not to compete.

Notes:

¹ 2009 CLLC ¶210-010. To be reported in Issue 1374 of the *Canadian Labour Law Reporter*.