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The Supreme Court Rules on the Enforcement of Restrictive Covenants

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In an important decision released today, the Supreme Court of Canada has found that restrictive covenants in employment contracts intended to limit an employee's right to compete against its employer after the employment relationship ends will be unenforceable if they contain ambiguous language or unreasonable terms, subject only to very limited exceptions. This case sends a clear signal to employers that courts will not step in to "save" and enforce employment contract language that is deficient or overbroad. Accordingly, employers seeking to rely on such language risk losing the ability to protect their interests from departing employees and competitors alike.

FACTS AND CASE HISTORY

In *Shafron v. KRG Insurance Brokers (Western) Inc*., Morley Shafron was employed by KRG Western pursuant to a series of employment contracts. The contracts contained non-competition language restricting his ability to compete with KRG Western, should he leave its employ, in the "Metropolitan City of Vancouver". When Shafron began working for another agency in Richmond, B.C., KRG Western commenced an action to enforce the covenant against Shafron. However, "Metropolitan City of Vancouver" had no legal meaning, as no such entity existed, and the geographic scope of the prohibition was therefore ambiguous. Where, as in this case, an employment-related restrictive covenant is ambiguous (i.e. "what is prohibited is not clear as to activity, time, or geography"), the covenant is said to be unreasonable and unenforceable, unless the ambiguity can be resolved.

The trial judge dismissed KRG's claim against Shafron. However, the Court of Appeal purported to apply the legal doctrine of "notional severance" (which involves "reading down" a contractual provision so as to make it legal and enforceable) to resolve the ambiguity, and sought to give effect to the parties' intentions by defining the term "Metropolitan City of Vancouver" to mean "City of Vancouver, the University of British Columbia endowment lands, Richmond and Burnaby".

THE SUPREME COURT SPEAKS

The Supreme Court has now clearly stated that courts cannot invoke the doctrine of notional severance to "save" employment-related restrictive covenants that are otherwise ambiguous or unreasonable. It identified two reasons: first, in the case of an unreasonable restrictive covenant,

there is no “bright-line” that can be applied in all cases to render covenants reasonable. In the employment context, applying notional severance would amount to the court rewriting contractual terms in a manner that it subjectively considers reasonable in each individual case. Such an approach would create uncertainty as to what might be found to be reasonable in any specific case.

Second, and of greater significance to employers, the Court found that the practice would essentially “invite” employers to impose unreasonable terms on employees, with the knowledge that the court would read the language down and enforce the covenants to whatever extent the parties “might” have agreed to. It would, in the Court’s view, provide “no inducement to an employer to ensure the reasonableness of the covenant and inappropriately increases the risk that the employee will be forced to abide by an unreasonable covenant”.

In trying to unilaterally resolve the ambiguity, the Court of Appeal in this case had effectively rewritten the covenant “in order to reflect its own view of what the parties’ consensus *ad idem* might have been or what the court [thought] was reasonable in the circumstances”. This was an error of law, for the reasons described above. Moreover, the doctrine of “blue-pencil” severance (where part of a contract is excised) could only be resorted to “sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purport of the restrictive covenant”, and had no application here.

The Supreme Court restored the trial judge’s decision dismissing KRG Western’s claim to enforce the covenant.

LESSONS FROM *SHAFRON*

Shafron is the Supreme Court’s most recent and succinct statement of the law in Canada surrounding the enforceability of restrictive covenants. We have recently been involved in two similar cases, both involving the issue of how far a court can go in rewriting the terms of a restrictive covenant to give it effect. One case is to be heard by the Court of Appeal in the near future, while opposing party is currently seeking leave to appeal the other matter to the Supreme Court of Canada. Hopefully, *Shafron* will bring some needed clarity to these complex and challenging issues.

Presently, the Court’s decision stands as a clear signal that in order for employers to protect their interests with respect to departing employees, employers must ensure that contractual restrictive covenant language is unambiguous and reasonable. Your Hicks Morley lawyer would be pleased to review your organization’s employment contracts for consistency with this new ruling, or provide you with further guidance in light of this significant decision.

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