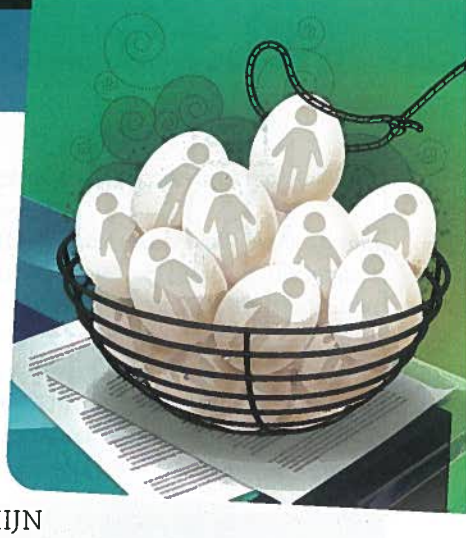

Putting the 'strict' into restrictive covenants

Employment lawyers are noticing a more vigorous application of the principles at all stages of the court process. BY JUDY VAN RHIJN

All over the country, courts are putting the "strict" into restrictive covenants. Not only are they shaking up the generally accepted position that non-solicitation clauses are easier to enforce than non-competition clauses, they are pulling the rug out from under injunction-based strategies and forcing litigants down the more traditional and difficult path towards damages.

While the legal principles connected with the use of restrictive covenants in employment contracts are well-established and generally consistent across the country, employment lawyers are noticing a more vigorous application of the principles at all stages of the court process.

Practitioners in Alberta have been surprised by a recent decision where their Court of Appeal took an extremely narrow view of a non-solicitation clause. In *Globex Foreign Exchange Corp. v. Kelcher*, it refused to enforce a non-solicitation clause, finding that its references to "dealings" and "any business or activity" were ambiguous and therefore unreasonably wide. Tom Ross, a partner at McLennan Ross LLP in Calgary says it is not surprising the Court of Appeal took a very strict approach, but it is surprising how far it went with it. "They went much farther than necessary and contrary to what people would expect," he comments. "Things that seem pretty obvious to a person when reading the covenant, they found to be ambiguous."

Ross generally advises his clients that if they can be satisfied with a non-solicitation clause, then they should leave it at that. "There is a clearer connection between a legitimate business concern and the potentially offending conduct than with a non-competition clause. But this case shows that even non-solicitation clauses are not immune from attack. It will have a very chilling effect on actions in general."

Elsewhere in Canada, the decision is not causing as much surprise as it has in Alberta. "In Ontario there is clear direction from the Court of Appeal with respect to non-solicitation clauses in *Lyons v. Multari*," says Connie Reeve of Blake Cassels & Graydon LLP in Toronto. "*Globex* is absolutely in line with the position in Ontario. The protectable interest is the special relationship between the employee and the employer's customers that he or she dealt with."

Reeve still sees old non-solicitation covenants that purport to restrict contact with *any* customer. "A company can have customers all over the world that the employee never dealt with. The courts are saying, "Not so fast. The employee didn't have a special relationship with them."

According to Jeff Goodman of Heenan Blaikie LLP in Toronto, the most significant trend he and his Ontario colleagues are seeing is procedural in nature, with much greater scrutiny of the merits of a case at the interlocutory stage. "We are not seeing nearly as many successful motions for injunctions as we used to. In past times, when a former employee joined the competition or began soliciting a client, the employer would obtain a 10-day injunction, and some kind of settlement would then follow. More often than not, whoever got the injunction won the day and the matter was only litigated in a preliminary way. The company stopped the departed employee's behaviour that they were concerned about, and moved on."

This meant that the difficulties of proving the extent of the breach and the quantity of the loss rarely had to be grappled with. "These are cases, not about 'How do you get the caramel in the caramel bar?' but about a permanent loss of clients which would do you irreparable harm," explains Goodman. "Say you lost McDonald's as a client; formerly you would say, you can't calculate that sort of damage, so the appropriate remedy is an injunction."

This began to change when Justice Ian Nordheimer in *Nesbitt Burns Inc. v. Lange* and then Justice David Corbett in *BMO Nesbitt Burns Inc. v. TD Waterhouse Investor Services* said you can calculate the loss in financial terms. Recent decisions apply the reasoning that, even though the loss is significant, if the company is likely to stay in business and the loss is capable of monetary calculation, the injunction will not be granted. The ability of computer technology to very quickly provide detailed information on clients now assists with the calculation of present and projected losses. This includes the normal attrition rate for clients and the size of each client investment. The judicial attitude seems to be that the plaintiff may not get any lost clients back, but they can be compensated for the loss if the main action is successful.

The Supreme Court of Canada endorsed this approach in *RBC Dominion Securities v. Merrill Lynch Canada Inc.*, which started when the Superior Court in British Columbia refused to issue an injunction and said this kind of case can be settled

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by an action in damages. Merrill Lynch was ultimately ordered to pay millions of dollars in damages. "So now we are seeing less injunctions and more trials for damages," Goodman observes. "In the vast majority of cases, we are now litigating in a more traditional way."

In Atlantic Canada, neither the substantive nor procedural tightening up comes as a shock. Level Chan, an associate at Stewart McKelvey in Halifax, states that traditionally, the courts of Atlantic Canada have been much more scrutinizing of restrictive covenants and that it has always been difficult to get injunctions. "The challenge is to show irreparable harm. A lot of actions still claim injunctions or potential injunctive relief but then move to negotiation." He points out that a claim for damages is definitely a challenge in terms of evidence. "To show what the loss is you have to point to a particular client or customer whom you lost. There is very rarely that kind of smoking gun."

Ross does not believe employers will ever want to abandon the injunction stage in favour of just seeking damages because of the need to cut off the activity. "In Alberta the injunction stage is still the most important stage of a complaint. Damages arise more where the behaviour has gone on for a while and the injunction rings a bit hollow."

However, Christopher McHardy of McCarthy Tétrault in Vancouver sees an advantage in foregoing the injunctive stage. "If an employer says they would like you to get an injunction, you immediately ramp up. It's very time intensive, and you have to get strong evidence right off the bat, usually from the customers. People don't want to drag their customers into a court proceeding. Worse yet, if there's any weakness in the clause, the application for an injunction is likely to fail and the other side will know it's unenforceable. That gives them *carte blanche* to compete or solicit as they want."

McHardy points out that if you make a claim, it creates a bit of a freeze, and to the extent that there may be any damages, they are starting to accrue. "So by comparison, an action for damages may slow down the defendant's efforts to compete, irrespective of whether the covenant is enforceable or not."

In Quebec, where restrictive covenants are governed by the Civil Code, there is no sign of a trend away from injunctions, according to Bernard Synnott, a partner at Fasken Martineau DuMoulin LLP in Montreal. "Here in Quebec, if the other party can demonstrate that the plaintiff will get a better ending with damages, the judge could refuse, but frankly, it never happens. When you have a clear covenant that respects all the criteria of the Civil Code, an injunction will be granted."

What Synnott is observing is an increased sophistication amongst employers. "There is a trend to treat what you can and cannot do more narrowly. Employers are distinguishing between clients assigned by the firm and those brought to the firm personally by the employee, by cold calls or other means. They are only forbidding the employees from soliciting the assigned clients. This is a new approach that we are seeing in Quebec."

Chan agrees that employers are becoming more sophisticated. "Absolutely. We are getting a lot more requests from our clients to review their covenants and make sure they are enforceable. Where there are clauses that they have used for some time, or that came to them from a national office or a U.S. parent, they are very conscious that they may not cut the mustard."

This all comes back to the judicial push, originally emanating from the 2009 SCC decision in *Shafron v. KRG Insurance Brokers (Western) Inc.*, for more careful drafting. It gives strong direction to judges not to rewrite or "read down" overly broad restrictive covenants as this practice encourages employers to impose unreasonable restrictions on their employees. "Employers have typically taken as much as they can get and not what they need," says McHardy. "This has been the source of many decisions where restrictive covenants have not been enforced."

Reeve hopes to see people beginning to draft more carefully. "If the restrictive covenant is not carefully drafted, an employer will have zero chance of an injunction or damages. Basically, it is all or nothing. If the covenant is too broad, an employer is not entitled to a remedy for its breach."