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Restricting the Restrictions: Limits on an Employer's Ability to Impose Restrictions on Ex-Employees

Melanie A. Polowin

Many employers mistakenly believe that all ex-employees are subject to non-solicitation and non-competition obligations, also known as restrictive covenants. However, recent court decisions from the Ontario Court of Appeal in *Staebler*¹ and the Supreme Court of Canada in *Shafron*² demonstrate why employers urgently need to review, revise and update their restrictive covenant practices and provisions.

The Basics

Unless a restrictive covenant is written, employers have little – if any – protection against post-employment solicitation and competition from a former employee. Furthermore, there are significant differences in how courts deal with different types of restrictive covenants.

- *Non-competes*: A non-compete limits the ex-employee's freedom to choose what type of work to do and where to do it. Even if reasonable in duration and scope, a non-compete is only enforceable in exceptional circumstances against a very limited group of employees – typically, key inner-circle executives and founders.
- *Non-solicits*: A non-solicit limits only certain kinds of "raiding" or "interference" activities directed at customers, prospects, former co-workers and, sometimes, suppliers. A non-solicit, if reasonable in duration and scope, will normally be enforceable against a wide range of employees.

- *Hybrids*: A hybrid typically blends non-compete and non-solicit features, whether accidentally, due to unclear drafting, or deliberately. For example, a hybrid might bar an ex-employee from soliciting, attempting to solicit or accepting business from customers. When non-competes and non-solicits cannot be easily distinguished, satisfying the test for enforceability is much harder. It is no longer safe to use hybrids!
- *Employee v. stakeholder restrictions*: The legal test for enforceability against an employee is much stricter than the legal test for enforcing restrictive covenants against the same individual in his or her capacity as a vendor, owner or shareholder. Therefore, covenants in transaction-related documents or shareholder agreements are normally much more reliable (and can be broader) than those contained in employment agreements.

The law views workforce mobility and a free market economy as being in the public interest. Restrictive covenants, by contrast, act in restraint of trade. While such restraint is permitted to a degree, restrictive covenants are only enforceable if they are reasonable between the specific parties and are in the public's interest. As a side point, protecting confidential and proprietary information is also considered to be in the public's interest. However, employers must not use restrictive covenants to prevent the disclosure or

misuse of proprietary information. This should be accomplished by means of separately written confidentiality and ownership of proprietary property provisions.

Enforceability is a Function of Both Valid Process and Proper Content

For any employment-related agreement, enforceability depends on both process and content. The validity of process depends on timing (seeing v. signing v. start date), the “consideration” (or exchange of value) made between the parties, both at the time of sign-up and afterwards, and whether steps taken since sign-up have interfered with continued enforceability.

Proper content depends on:

- The type of restriction, the length of the restriction period, the geographic reach of the restriction and the type of conduct restricted;
- The overall agreement in which the covenant is located; whether that agreement itself is enforceable; and the nature of the relationship between the parties; and
- The relevant circumstances, including what is considered typical in the industry; the level and role of the ex-employee; the duration and nature of the ex-employee’s relationship with the employer’s customers, employees and business contacts; and whether the ex-employee has breached any confidentiality obligations or has “clean hands.”

In light of these factors, an employer must satisfy a three-step test:

1. Does the employer have a valid interest that requires protection? Wanting to prevent competition is not, in itself, a valid interest. As a general rule, customer-supplier relationships (trade connections) and employee-consultant relationships (staff connections) are valid interests warranting reasonable protection.

2. Is this restriction necessary to protect the valid interest? For example, if the ex-employee has never had dealings with clients, then a non-solicit prohibiting the solicitation of clients may not be warranted.
3. Is this restriction reasonable and minimally intrusive? Consideration must be given to geographical restrictions, how the “protected group” of trade connections or staff connections is defined and the type or scope of the restricted activities. Again, the courts assess reasonableness both as between the parties and with reference to the public interest.

Overreaching is the mistake employers most commonly make and it leads to unenforceability. Employers often impose excessive time frames or unduly broad geographical restrictions, protect relationships that are unconnected to the former employee or insist on unnecessary non-competes. *Staebler* teaches us that, as a general rule, courts will not carve down excessive limits or substitute enforceable limits; instead, they will throw out the baby with the bathwater, striking down an offending covenant entirely.

A lack of clarity that arises from vague and unclear drafting is the second most common mistake that leads to unenforceability. *Shafron* teaches us that it is the employer’s job to write a clear and valid covenant. As a general rule, courts will not fix a covenant by rewriting unclear wording.

Therefore, employers take heed: dust off templates and old agreements, and work with employment counsel to overhaul and update restrictive covenant provisions and sign-up practices. Remember, even if the content is perfect, enforceability can be destroyed by procedural problems. Be clear and reasonable, and avoid a one-size-fits-all approach — only then will you improve the odds of being protected.

¹ *H.L. Staebler Company Limited v. Allan*, 2008 ONCA 576 (CanLII)

² *Shafron v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6. No. 31981