ON THE CASE

Ambiguous Non-Competition Agreements Are Unenforceable, Says Supreme Court of Canada

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The Supreme Court of Canada has ruled that non-competition clauses and other restrictive covenants in employment contracts will be unenforceable if any of their key terms are ambiguous. In *Shafron v. KRG Insurance Brokers (Western) Inc.*, released January 23, 2009, the Supreme Court stated that, as a matter of policy, the courts should not come to the aid of employers who use unclear contractual language to define the scope of their employees' post-employment obligation not to compete.

Background

The *Shafron* case involved a senior employee at an insurance brokerage who signed an employment agreement containing a post-employment non-competition covenant. The covenant provided that during the three-year period following the end of employment, the employee was prohibited from being employed in the business of insurance brokerage within the Metropolitan City of Vancouver. One month after the employee left his job, he began working for another insurance brokerage in Richmond, British Columbia – a suburb of the City of Vancouver. The employer sued to enforce the non-competition agreement.

The trial judge found that the non-competition covenant was unenforceable because the geographic area covered by "Metropolitan City of Vancouver" was unclear, and the covenant's three-year term was unreasonably long. The British Columbia Court of Appeal reversed the trial decision, and found that the three-year term was reasonable. The Court of Appeal also found that, although ambiguous, the term "Metropolitan City of Vancouver" could be construed to refer to the cities of Vancouver, Richmond, and Burnaby as well as the University of British Columbia Endowment Lands.

Supreme Court's Decision

The Supreme Court unanimously overruled the Court of Appeal decision and reinstated the trial judgment. In its decision, the Supreme Court clearly stated the circumstances in which a restrictive covenant in the employment context will be unenforceable. The Supreme Court confirmed that these covenants are presumptively unenforceable unless their scope is reasonably limited in duration, in geographic coverage, and in the nature of the prohibited business activity. Moreover, in the employment context these three limitations must be expressed in clear, unambiguous language, or a court will decline to enforce the covenant, without assessing its reasonableness.

The Supreme Court declined to apply traditional contractual interpretation principles to clarify the ambiguous phrase "Metropolitan City of Vancouver" in order to render the non-competition covenant reasonable and enforceable. The Supreme Court was concerned that applying those interpretation principles would invite employers to impose unreasonable or unclear terms on their employees. There would be no sanction for the employers other than a narrow judicial construction of the covenants, while employees would be subject to an increased risk of having to abide by unreasonable covenants. The Supreme Court concluded that the best way to compel employers to draft clear and reasonable non-competition covenants was not to enforce a covenant drafted in unclear or unreasonable terms. This is consistent with Canadian courts' traditional refusal to rewrite (or "blue-pencil") restrictive covenants.

The Supreme Court confirmed that courts should accord a more relaxed treatment to non-competition covenants found in agreements for the sale of a business. Where a business is being sold, courts will defer to the parties to the agreement and apply less rigorous scrutiny to the agreed-upon non-competition terms, for two reasons. First, parties to a business sale agreement generally benefit from greater equality of bargaining power; second, the purpose of the sale transaction is generally to transfer the business's goodwill along with its other assets. More onerous non-competition covenants are permitted in this context because the existence of competition reduces the value of the goodwill.

Canadian courts have generally been reluctant to enforce lengthy post-employment non-competition clauses, particularly covenants lasting more than two years following the end of employment. The Court of Appeal's enforcement of a three-year non-competition covenant in this case was a significant relaxation of the reasonable duration requirement in favour of employers. Although the Supreme Court restored the trial judge's finding that the non-competition agreement was unenforceable because of its ambiguity, the Supreme Court did not consider the question whether the three-year term was reasonable. Whether the Court of Appeal's decision on this issue is the start of a new trend in employment law remains to be seen.