

Commercial Non-Competition Clauses Are Enforceable, Ontario Court Of Appeal Rules



This blog was completed with the assistance of Summer Law Student Lauren Hill.

The recent decision of the Ontario Court of Appeal in *Dr. C. Sims Dentistry Professional Corporation v Cooke*, 2024 ONCA 388 has confirmed the enforceability of non-competition covenants entered into in the context of purchase and sale agreements of businesses.

Pursuant to a purchase and sale agreement of a dental practice, the seller dentist agreed to a non-competition covenant (also known as a “non-compete”) that prohibited the seller dentist from directly or indirectly engaging in the practice of dentistry within a 15 kilometre radius of his former practice for five years.

Less than three years following the execution of the purchase and sale agreement, the seller dentist began working at a dental practice 3.3 kilometres away, taking the position that the non-competition clause was unenforceable.

The purchaser dentist objected and commenced an action in response, with the Superior Court of Justice ultimately deciding in the purchaser dentist’s favour, affirming the enforceability and reasonableness of non-competition covenants negotiated as part of the sale of a business. The seller dentist appealed to the Ontario Court of Appeal, arguing that the trial judge erred in concluding that the non-competition covenant was reasonable in terms of its duration and geographic scope.

In commercial contexts, restrictive covenants are deemed to be lawful unless shown to be unreasonable

Despite the seller dentist’s claim that the onus to prove the enforceability of a non-competition covenant rested on the party seeking to enforce the covenant, the Court of Appeal agreed with the trial judge’s adoption of *Payette v Guay inc.*, 2003 SCC 45 as authority that “[i]n a commercial context, the restrictive covenant is deemed to be lawful unless it can be shown to be unreasonable.”

This finding departs from the judicial preference to scrutinize the reasonableness – and thus, enforceability – of non-competition covenants made in employment agreements, instead applying a presumption of validity to covenants negotiated as part of commercial purchase and sale transactions. The Court held that parties to a commercial agreement for the purchase and sale of a business are best placed to

determine what is reasonably required to protect the purchaser's interest in the goodwill, and as such, enjoy greater freedom of contract as compared to workers entering into employment contracts.

The Court of Appeal also found that the trial judge properly evaluated the nature of the bargaining relationship and the relative bargaining power between purchaser and seller. Specifically, the Court acknowledged the facts that both parties were represented by legal counsel and had equal bargaining power in the negotiations of the transaction, and relied on evidence that the seller's solicitor did not identify any concerns or issues with the scope and duration of the non-competition covenant at the time the purchase and sale agreement was executed.

In determining the reasonableness of a non-competition covenant's duration, the nature of the business matters

The Court of Appeal rejected the seller dentist's challenge to the reasonableness of the non-competition covenant's duration entered into as part of the purchase and sale agreement.

The Court stated that the reasonableness of duration of non-competition covenants depends on the nature of the business and the particular circumstances. In considering the nature of the dental industry, the Court of Appeal approved of the trial judge's decision to accept the purchaser dentist's evidence that the five-year period reflected the time and visits required of a patient to build a trusting relationship with their dentist.

Radius-based approach in determining geographic scope of a non-competition clause may be acceptable

On the geographic scope of the non-competition covenant, the Court noted that, generally, the geographic scope should be limited to the area in which the business being sold carries on its trade or activities as of the date of the transaction.

However, the Court of Appeal found that the trial judge was only required to determine whether the geographic scope of the non-competition covenant was reasonable, and not whether, according to the seller dentist, it mapped exactly to the trading area described in the valuation report considered in negotiations.

The Court further noted that a radius-based approach to geographic scope, rather than locale-based, was deemed appropriate in other cases involving dental practices, reflecting how far a customer might be willing to travel to access services.

Implications

Parties to a purchase and sale agreement should assume that non-competition covenants agreed upon in the process of a commercial transaction will be presumed to be legally enforceable. However, proper advice respecting appropriate geographic scope and temporal limitations remains critical to put the parties in the best position to ensure their commercial deal is respected.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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