

Court Confirms The Enforceability And Viability Of Restrictive Covenants Within M&A Transactions



Case Summary: Dr. C. Sims Dentistry Professional Corporation v. Cooke

Background

In *Dr. C. Sims Dentistry Professional Corporation v. Cooke*, 2024 ONCA 388, the Ontario Court of Appeal elucidated several critical aspects concerning the enforceability of restrictive covenants within the context of business purchase and sale agreements.

Key Facts:

- In July 2017, Dr. Sims acquired all shares of Dr. Cooke's dental practice for \$1.1 million.
- A non-solicitation/non-competition clause prohibited Dr. Cooke from practicing dentistry within a 15 km radius of the practice for five years following the termination of his association with the practice.
- In 2020, after the termination of his association, Dr. Cooke announced his intention to practice at a dental office located 3.3 km from the original practice, asserting that the non-competition clause was unenforceable. Dr. Sims objected and initiated legal proceedings.

Issue: Enforceability of Restrictive Covenants in Ontario

In Ontario, non-competition and non-solicitation clauses are generally enforceable in the context of business transactions, provided they are reasonable in scope and duration. Courts typically uphold such covenants to protect the goodwill and value of the business being sold. These covenants must, however, balance the interests of the purchaser in protecting their investment with the seller's right to continue earning a livelihood.

The Superior Court of Justice ruled in favor of Dr. Sims, upholding the enforceability of the non-competition clause. Dr. Cooke appealed the decision, contending that the trial judge erred in determining the reasonableness of the covenant.

Court of Appeal Decision

1. Enforceability of Restrictive Covenants in Business Sale Agreements:

- The Court of Appeal clarified that the rules governing employment contracts differ from those pertaining to business sale agreements, with the latter affording parties greater latitude to protect their interests.
- The Court emphasized that in commercial agreements where parties are competently advised and possess equal bargaining power, judicial intervention to overrule the parties' judgment of reasonableness should occur only in exceptional circumstances.
- The Court noted that the valuation, which incorporated the non-competition covenant, was an integral part of the letter of intent and share purchase agreement, indicating a mutual and deliberate decision by the parties.

2. Reasonableness of Duration:

- The Court affirmed that while restrictive covenants with a duration of five years are frequently deemed reasonable, the specific context and nature of the business must be considered.
- The trial judge's decision referenced evidence suggesting that establishing patient trust can take several years, thereby justifying the five-year duration of the covenant.
- The Court noted that there was evidence indicating that several patients were likely to follow Dr. Cooke if he relocated nearby, further supporting the reasonableness of the covenant's duration.

3. Reasonableness of Geographic Scope:

- The Court held that the territory encompassed by a restrictive covenant generally corresponds with the business's operational area at the time of the transaction.
- The Court recognized that a 15 km radius had been considered reasonable in analogous cases involving dental practices, and in any case, the geographic scope need not precisely match the "trading area" described in the valuation.

Key Takeaways:

- **Main Principle:** In commercial agreements, competently advised parties with equal bargaining power are best positioned to determine reasonable terms. Judicial intervention will thus be rare.
- **Duration:** Five-year non-competition covenants are frequently found to be reasonable, subject of course to the nature of the business and client/customer behavior.
- **Geographic Scope:** The territory defined by a reasonable restrictive covenant should approximate the business's operational area at the time of the agreement.

This case reaffirms the enforceability of restrictive covenants in business sale agreements, provided they are reasonable and mutually agreed upon by competently advised parties.

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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