Enforceability of non-competition clauses

Canadian employers regularly attempt to protect their interests through “non-competition” clauses in their employment agreements, particularly when hiring employees who will play a key role within the employer’s organization, have access to sensitive client/customer information, and/or work closely with the employer’s key customers.

While a non-competition clause can be a useful tool in protecting employers’ interests, enforcing non-competition agreements can be a time-consuming, costly, and difficult endeavour. Canadian common law favours a competitive labour market and presumes that non-competition clauses are void as an unacceptable restraint on trade. The employer bears the onus of establishing that a non-competition restriction should be enforced as a reasonable limit.

For a non-competition clause to be enforceable, employers must ensure that it is reasonable and unambiguous with respect to the geographic scope of the restriction, the timeframe that the non-compete applies, and the scope of activity restricted. Courts routinely refuse to enforce non-competition clauses where the geographic scope or timeframe is more than necessary, or where the prohibited activity includes activities that are not in fact “competitive” with the employer, or goes beyond what the employee was doing, and what is reasonably required to protect the employer’s interest.

Courts will also refuse to enforce a non-competition clause where a less restrictive non-solicitation clause prohibiting the former employee from directly soliciting business from the employer’s customers or clients would have provided adequate protection.

What is “reasonable” is a very fact-specific analysis and can differ greatly depending on the circumstances. For example, a company operating in a remote rural area with no competition in the surrounding region may have more success enforcing a wider-ranging non-competition clause than a company operating in a dense urban centre, heavily saturated with competitive businesses.

Ambiguity is also fatal. For example, Courts have recognized a difference between “a 5 km radius” and “within 5 km.” While “a 5 km radius” is clear, “within 5 km” may be ambiguous – does it refer to a 5 km radius, or within 5 km of travel by car? If an employee ends up working at a competitor within 4.8 km as the crow flies, but 5.3 km by car, a non-competition clause contemplating a restriction “within 5 km” may be ambiguous and therefore unenforceable.

Ontario is the first Canadian jurisdiction to expressly prohibit non-competition clauses. Part XV.1 of the Ontario *Employment Standards Act, 2000*, SO 2000, c 41 (the "Act") prohibits non-competition clauses in employment agreements entered into after October 25, 2021. Specifically, sections 67.1 and 67.2 prohibit "an agreement, or any part of an agreement, between an employer and an employee that prohibits the employee from engaging in any business, work, occupation, profession, project or other activity that is in competition with the employer's business after the employment relationship between the employee and the employer ends."

The prohibition in the Act is subject to two primary exceptions: (1) executive employees; and (2) non-competition agreements included in agreements for the sale of a business.

Executive employees include any person who holds the office of chief executive officer, president, chief administrative officer, chief operating officer, chief financial officer, chief information officer, chief legal officer, chief human resources officer or chief corporate development officer, or holds any other chief executive position.

The sale-agreement exception applies to the seller, and the employees of the seller, if they are subsequently employed by the purchaser immediately after the sale. How long the employee must be employed for immediately after the sale has yet to be determined.

While the Ontario Act does bring certainty and clarity to Ontario moving forward, the normal uncertainty surrounding the enforcement of employment agreements entered into prior to October 25, 2021 still exists. For these employees, and for "executive employees" or employees falling within the sale-agreement exception, the employer will still need to establish that the non-competition clause is reasonable and unambiguous.

A departing employee, particularly if in a key role with extensive knowledge of the employer's operations, can provide a significant advantage to a competitor. A properly drafted and considered non-competition clause can help mitigate employers' risks as employees come and go. This is particularly true if one considers that litigation involving former employees routinely begins with complex, time-sensitive, and costly injunction applications. An enforceable non-competition clause not only helps protect an employer's interests, it helps ensure that if the employer must go to court to protect its interests, then its time, money, and efforts may not be wasted. Properly drafted non-solicitation provisions can also back stop non-competition provisions to protect customer relationships and employees.

In all cases, Canadian employers are well advised to seek legal advice when drafting and entering into non-competition agreements. Experienced legal counsel can help ensure clear and unambiguous terms in the agreement and work with the employer to determine what, in their specific circumstances, is "reasonable."

If you have questions about non-competition clauses, or other labour and employment matters, please reach out to a member of Miller Thomson's Labour & Employment Group.

Source: Miller Thomson

Written By: Danny Alcorn