Inhibit Don’t Prohibit – The B.C. Court Of Appeal Upholds Restrictive Covenant Placing Price Tag On Competition

Subsequent to obtaining a license to practice veterinary medicine, Dr. Stephanie Rhebergen entered into a 3 year Associate Agreement with Creston Veterinary Clinic (the “Clinic”) to obtain the necessary field training.

The Agreement contained a noncompetition clause that required Rhebergen to pay a prescribed amount in the event she set up a veterinary practice within 25 miles of Creston during the first, second or third year after the Agreement was terminated (the “Clause”).

The amounts to be paid by Rhebergen under the Clause were based on the costs that, in the Clinic’s view, would not be recovered unless she remained with the Clinic for three years. Such costs included mentoring, training, and equipment costs, as well as the impact on the Clinic’s goodwill.

Differences arose between Rhebergen and an owner of the Clinic after 14 months, at which time Rhebergen sought to terminate the Agreement and cease working for the Clinic. The Agreement did not provide Rhebergen with the right to terminate but permitted the Clinic to terminate for just cause. The Clinic informed Rhebergen that she was precluded from terminating and then exercised its right to terminate her for cause.

Five months later, Rhebergen filed a notice of claim in which she pleaded that she intended to “set up a mobile dairy veterinary practice in Creston and vicinity” and sought to have the Clause declared unenforceable.

Chambers Decision

The Chambers judge recognized that the Clause did not prohibit Rhebergen from setting up a practice within 25 miles of Creston but only required that she pay the Clinic prescribed amounts if she did. He nonetheless considered the Clause to constitute a restraint of trade.

The judge determined that the Clause was not enforceable because it was unreasonable for two reasons: (1) the Clause was ambiguous due to the number of possible interpretations of the phrase “sets up a veterinary practice”; and (2) the amount to

be paid under the Clause constituted a penalty.

B.C. Court of Appeal Decision

The B.C. Court of Appeal allowed the appeal. The question before the Court was whether the Clause constituted a restraint of trade and, if so, whether it was a reasonable restraint such as to be enforceable.

The Court unanimously agreed that the Clause was a restraint of trade. In making this determination, the Court adopted the so-called "functional" approach, which asks "whether the clause at issue attempts to, or effectively does, restrain trade, in which case it will be captured by the doctrine and subjected to reasonableness scrutiny". This stands in contrast to the "formalist" approach, which requires the clause to be structured as a prohibition against competition in order to trigger the doctrine of restraint of trade.

In the Court's view, although the Clause was not a conventional non-competition clause in that it contained no prohibition, the payment was a restraint because it compromised Rhebergen's opportunity to compete with the Clinic.

The Court also unanimously agreed that the payments to be made by Rhebergen were not a penalty but rather compensation for the costs incurred by the Clinic in training Rhebergen and which she herself acknowledged were reasonable. While the costs were not particularized as well as they might have been, they were neither extravagant nor unconscionable.

The issue on which the Court divided was the issue of ambiguity. The dissenting judge determined that the Clause was ambiguous because it failed to define at what point in time Rhebergen's provision of professional services would trigger the payment obligations.

The majority found no such ambiguity, finding that the objective meaning of the Clause could be determined from the plain and ordinary meaning of the words used by the parties, the factual matrix in which the Agreement was made, and the manner in which the issue was brought before the Court. The majority held that in the absence of any other established clinic in the area, Rhebergen could not provide veterinary services without setting up her own practice.

According to the majority, it was immaterial where on the spectrum Rhebergen proposed to provide veterinary services within the 25 mile radius. Her intention to provide those services on a regular and continuous basis was sufficient to trigger the Clause. The majority also noted that Rhebergen's stated intention when commencing her action was to "set up" a practice in order to compete with the Clinic.

Conclusion and Take-Away

As already noted, the Clause differed from a conventional non-competition clause because it contained no prohibition. In a conventional clause, it is the prohibition itself that constitutes a restraint of trade, whereas the Clause (otherwise known as a permissive clause) may be considered a restraint only because of the financial consequence for which it provides. Absent extenuating circumstances, conventional non-competition clauses are generally not enforceable.

While authority stemming from Ontario appears to favour the formalist approach, this case suggests that, in B.C., the Court is more likely to enforce a restrictive covenant that merely inhibits rather than prohibits.

However, as always, employers need to be cognizant of the fact that a “one size fits all” approach is not appropriate when crafting a restrictive covenant. Apart from the need for the covenant to be clear, understandable and unambiguous, it must also be reasonable in all of the circumstances.

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