Legal Precedent On Restrictive Covenants In Employment Agreements—A Case Study

Employee restrictive covenants are often a contentious issue, especially when employees leave to form (or join) competing firms.

A recent Alberta Court of King's Bench decision, *People Corporation v Quinn et al.* (2024 ABKB 711), offers valuable insights into how courts balance the enforceability of restrictive covenants, employee rights, and employer interests. This case revolves around allegations of breach of restrictive covenants and the legal intricacies involved in assessing their validity.

Case Background

The case stems from People Corporation's share acquisition of Lane Quinn Benefit Consultants Ltd. (LQBC). As part of the acquisition, Jay Quinn, LQBC's majority shareholder and CEO, signed an Executive Employment Agreement (EEA) and a Restrictive Covenants Agreement (RCA). Mr. Quinn later resigned from People Corporation to establish a competing firm, Quinn Advisory Group (QAG), and subsequently hired three former LQBC employees.

People Corporation sought injunctions against Mr. Quinn, the three former LQBC employees and QAG, alleging breaches of: contractual confidentiality, non-solicitation and non-competition clauses; and breaches of fiduciary duties arising at common law.

The Court assessed whether these clauses were enforceable and whether sufficient grounds existed for an injunction.

Key Legal Issues

1. Nature of the Restrictive Covenants

Mr. Quinn's restrictions in the RCA were time-limited and expired prior to his resignation. Therefore, People Corporation did not rely on the RCA, and instead relied on the non-solicitation and non-competition covenants in the EEA.

The court considered whether the EEA and its restrictive covenants were tied to (1) the commercial sale of LQBC by Mr. Quinn to People Corporation, or (2) his subsequent employment relationship with it.

This distinction is crucial, as the Court confirmed that restrictive covenants in employment contracts are subject to stricter scrutiny due to potential power imbalances between employers and employees.

The Court concluded that the restrictive covenants in the EEA were tied to Mr. Quinn’s employment relationship and not the commercial sale. In doing so, the Court highlighted many factors that are relevant to this determination, and relied on the following:

- While the restrictive covenants in the RCA were explicitly linked to the acquisition agreement, with recitals stating that People Corporation entering into the share purchase agreement was conditional upon Mr. Quinn entering into the RCA, the recitals to the EEA did not include such a statement.
- The EEA also included a provision that acknowledged that Mr. Quinn had “direct and indirect commercial relationships” with People Corporation and had thus given covenants in the context of the other relationships, but that the covenants in the EEA were “not intended to be overridden, restricted or amended” by those other covenants. In addition, the EEA contained an entire agreement clause that provided that it contained “the entire agreement between the parties hereto with respect to the employment” of Mr. Quinn.
- The provisions of the RCAs regarding confidential information, non-solicitation and non-competition were substantively the same as those in the EEA such that People Corporation protected itself with respect to the acquisition through the RCA, which the Court considered as further evidence that the EEA’s purpose was only to govern the contract of employment between Mr. Quinn and People Corporation.

2. Reasonableness and Ambiguity

The Court reiterated the following key principles regarding restrictive covenants arising from an employment relationship:

- They are *prima facie* unenforceable as restraints on trade that are contrary to public policy.
- A restrictive covenant will only be enforced if it is “reasonable”.
- Reasonableness is measured in terms of time, geography (with some exceptions), and scope.
- For a determination of reasonableness to be made, the terms of the restrictive covenant must be unambiguous.
- Reasonableness of the scope depends on whether the Applicant has a proprietary interest in the subject matter, whether the scope protects only that interest, and is unambiguous.

A court in not permitted to change the scope, time or geography of the agreement by rewriting, or notionally severing a restrictive covenant in an employment contract to reflect what the court thinks is reasonable. Therefore, if the clause is unreasonable, it is fully unenforceable and cannot be reduced to what would have been reasonable in the circumstances.

By contrast, while restrictive covenants in a commercial context must also be reasonable, unlike those found in employment relationships they are presumably enforceable, subject to offending public policy.

With these principles in mind, the Court deemed the definitions of “Clients” and “Prospective Clients” in Mr. Quinn’s EEA to be overly broad and ambiguous, making the non-solicitation and non-competition clauses unenforceable.

The definition of “Clients” in the EEA included all persons to whom a “member of the People Corporation Group” (which would include more than 2,700 employees of People Corporation and its subsidiaries across Canada) have sold products or provided services currently or within the 36 months prior to the alleged solicitation. The definition also included, not only established clients, but persons on whom a member of the people Corporate Group “maintains…a file” in their “active records”.

The definition of “Prospective Clients” included persons “who have been approached by or on behalf of any member of the People Corporation Group… within the 18-month period prior to” the date an alleged solicitation has taken place, despite not being a current client, and all persons “whom such member has determined should be approached…and in respect of whom a plan of action has been developed”.

The Court found that it would be impossible for Mr. Quinn to determine if clients approached by the staff of QAG would fall within these very broad definitions with certainty, rendering the clause overly broad and ambiguous, and thus unenforceable.

With respect to the non-competition clause, the Court also found the lack of geographical limits rendered the clause unreasonable and therefore unenforceable.

3. Common Law Duties

The other three former employees did not have contractual restrictive covenants. People Corporation argued that they were nonetheless fiduciaries of People Corporation, and therefore owed common law duties to People Corporation.

Quoting from the Supreme Court of Canada, Justice Romaine cautioned that such duties are “reserved for situations that are truly in need of the special protection that equity affords”, and that for a fiduciary obligation to attach to an employee, the employee must be able to exercise some independent power or discretion over the employer’s business. It is well established that the three defining characteristics of such a fiduciary employee are:

1. The fiduciary has scope for the exercise of some discretion or power.
2. The fiduciary can unilaterally exercise that power or discretion to affect the beneficiary’s legal or practical interests.
3. The beneficiary is particularly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

Fiduciary status is usually limited to a top, senior, key or executive management employee who is responsible for guiding the business affairs of the employer and necessarily involved in the decision-making process. However, Justice Romaine also noted that Alberta Courts have recognized a broader approach to when a lower-level employee may be found to be a fiduciary. In these cases, the vulnerability of the employer to unfair competition by the employee can give rise to an ad hoc fiduciary relationship. She held that this relationship potentially existed between People Corporation and one of the former LQBC employees, Mr. Patterson.

Mr. Patterson as an ad hoc Fiduciary

Justice Romaine found that Mr. Patterson was a sales consultant and account manager, he did not have scope for the exercise of discretion or power, he could not unilaterally exercise power, he was not responsible for guiding the business affairs of People Corporation, and he was not involved in the decision-making process. Nevertheless, Justice Romaine recognized that although Mr. Patterson would not ordinarily be considered a fiduciary employee, People Corporation, by the nature of its business, was particularly vulnerable to loss by soliciting of its clients’ business and recognized a potential *ad hoc* fiduciary duty given Mr. Patterson's close relationships with clients.[1] The court granted a limited injunction restricting his solicitation of People Corporation's clients until February 2025, one year after his resignation.

In contrast, Ms. Metez and Ms. Archer, both senior account managers, were not found to be fiduciary employees. Ms. Metez had relationships with far fewer clients than Mr. Patterson, had little (if any) scope for the exercise of discretion or power, and did not give any undertaking to act in People Corporation's best interest. Similarly, Ms. Archer was not a senior employee.

Legal Implications

This decision highlights several key considerations for employers regarding restrictive covenants:

1. **Drafting Clear and Reasonable Agreements**: Courts will not enforce ambiguous or overly broad restrictive covenants. Employers must ensure these clauses are specific, reasonable, and clearly linked to a legitimate business interest.
2. **Hybrid Agreements**: Where restrictive covenants are tied to both the sale of a business and an employment relationship, courts may apply stricter employment law standards to assess their enforceability.
3. **Fiduciary Duties**: Employees in positions of trust or influence may owe fiduciary duties to their employer, even in the absence of explicit restrictive covenants. An ad hoc fiduciary relationship may also arise in circumstances where the employer is particularly vulnerable to unfair competition by the employee, even where the employee is not an executive, senior manager, or otherwise 'key' employee.

Conclusion

The *People Corporation v Quinn* case is a valuable precedent for navigating the legal complexities of restrictive covenants and post-ownership and post-employment obligations. It underscores the importance of precise drafting and a balanced approach to safeguarding business interests without unduly restricting employee rights. For employers, this case serves as a reminder to review and refine employment agreements and policies to support the position the employer plans to take regarding departing employees, and to withstand judicial scrutiny.

Footnote

1 As this was an application for an interim injunction pending trial, the court did not decide whether Mr. Patterson was a fiduciary employee, but instead decided that People Corporation had established a strong *prime facie* case that he may have been.

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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