

# Restrictive Covenants – Context Matters!



[Payette v. Guay Inc.](#) is the latest decision from our highest court regarding the enforceability of restrictive covenants. The unanimous decision of the Supreme Court suggests that employers purchasing a business and retaining the services of previous owners will be better protected if restrictive covenants are contained in the purchase and sale agreement rather than in an employment agreement.

## **Facts**

Quebec crane rental company Guay Inc. (“Guay”) purchased the assets belonging to crane rental corporations controlled by Yannick Payette. As part of the purchase and sale agreement Mr. Payette was hired as a consultant for six (6) months, with an option to continue as an employee at the end of the six-month period. Further, as part of the purchase and sale agreement the parties agreed to restrictive covenants, a non-solicitation clause and a non-competition clause. The non-solicitation clause restricted Mr. Payette from soliciting or doing any business with Guay’s customers, attempting to solicit or do business with Guay’s customers and soliciting Guay’s employees for a period of five (5) years from the end of his employment with Guay. The non-competition clause restricted Mr. Payette from acquiring or participating in any business within the crane rental industry in the province of Quebec for a period of (5) years from the end of his employment.

Following the six-month transition period Mr. Payette was hired by Guay as a director and signed an employment agreement which did not contain restrictive covenants. After four (4) years of working at Guay Mr. Payette was dismissed without cause. Following his dismissal Mr. Payette entered into an employment relationship with a direct competitor of Guay. A few days later, seven (7) of Guay’s most experienced employees left Guay to work for the same competitor. Guay took legal action in an attempt to enforce the restrictive covenants and sought an injunction.

## **Lower Court Decisions**

The Quebec Superior Court refused to grant the injunction relying on article 2095 of the Civil Code of Quebec which prevents an employer from protecting itself through a restrictive covenant where it has terminated an employee without cause. On appeal the Quebec Court of Appeal reversed the decision on the basis that the restrictive covenants were agreed to as part of the transaction for the sale of assets rather than in consideration in an employment contract.

## **Supreme Court of Canada Decision**

In a unanimous decision, the Supreme Court of Canada (the “Court”) noted that the interpretation of restrictive covenants would depend on whether the covenants are found in employment contracts or in commercial agreements. Because of the imbalance of power that generally characterizes employer-employee relationships, the party seeking to enforce a restrictive covenant in an employment agreement will have to demonstrate that the covenant is reasonable. In the commercial context an imbalance of power is not presumed. What is presumed is that such clauses are included to enable the purchaser to protect its investment. As a result, a restrictive covenant in a commercial contract is enforceable, unless the party resisting its enforcement can show that its scope is unreasonable.

When a court is faced with a “hybrid” restrictive covenant as it was in this case, that is, a covenant that appears to apply in both the commercial context and the employment relationship, a court will have to look at the reasons the covenants were entered into and apply the appropriate set of rules to the covenants. In the case before the Court, the Court determined that the covenants were entered into for the purpose of the sale of business to Guay, not for the purpose of the employment relationship between Payette and Guay. As a result, the rules relating to restrictive covenants in the commercial context apply.

In addition to clarifying the rules with respect to restrictive covenants in the employment context and the commercial context, the Court also made two findings with respect to the particular covenants at issue that are significant to the general enforcement of restrictive covenants.

First, the Court noted that a non-competition clause must be limited as to time, or the court will refuse to give it effect. The non-competition clause at issue had a five-year term. Although on the lengthy side of typical non-competition clauses, the Court noted that this term is reasonable in light of the highly specialized nature of the crane rental business.

Second, the Court noted as a general rule that a non-competition clause that applies outside the territory in which the business operates is contrary to public order. The non-competition clause at issue prohibited Mr. Payette from competing anywhere in Quebec, notwithstanding the fact that the vast majority of Guay’s business activities were carried on in the Montreal area. The Court found that this territorial restriction was not unreasonable, noting that the unique nature and mobility of the crane industry justified the territorial area in the clause. In fact, the court stated that “in the context of the modern economy, and in particular of new technologies, customers are no longer limited geographically, which means that territorial limitations in non-solicitation clauses have generally become obsolete.”

### **Lesson for Employers**

While we are cautiously optimistic that this decision could influence the court to interpret a variety of restrictive covenants in a more liberal manner, employers must not view this decision as a green light to place stringent restrictions on their employees. In fact, the ratio of this case may be limited to the concept that restrictive covenants will always require a fact-driven analysis while those drafted in the commercial context allow for more flexibility than those drafted in the employment context.

Thus, it remains unadvisable to draft restrictive covenants of a five (5) year term in the employment context even where the business operates in a specialized industry. Further, in the employment context it is likely unwise to place

territorial/geographical restrictions that are broader than necessary and especially risky to draft a non-solicitation clause without any territorial or geographic limitation.

However, the Court's emphasis on the imbalanced bargaining power between employers and employees may leave the door open to employers' claims that restrictive covenants negotiated into sophisticated executives' employment agreements should be upheld as the concern of imbalanced bargaining power exists to a lesser extent, if at all.

To understand restrictive covenants in the employment context and some of the case law in this area please also view our blogs dated [March 14, 2013](#), [May 10, 2012](#) and [May 3, 2011](#). Lastly, should you require additional assistance in drafting, interpreting or revising restrictive covenants for your workplace consider consulting a CCP Lawyer.



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