Too-Long Non-Compete Periods Risk Being Overturned By Courts

“Be careful what you wish for.” This sage maternal advice isn’t just for children, it can also be applied to the more prosaic world of employment law.

In negotiating employment agreements with key staff who are in a position to take business with them when they leave, employers will try to protect themselves through non-competition agreements that include a period as long as they think a court will enforce. But might the length of that clause backfire when it comes to severance?

A recent decision of the Ontario Superior Court sheds some light on that.

Gregory Dimmer, a senior vice-president at MMV Financial Inc., which arranged financing loans for startup companies in the IT, life sciences and environmental sectors, was very successful in sourcing loan opportunities until MMV restructured his territory. After the restructuring he struggled to locate new deals. In March 2010 after four years of employment, Dimmer was terminated, without cause, at age 50.

Dimmer signed an employment agreement when he was hired that provided a restrictive covenant preventing him from working for any competitor of MMV for one year but which was silent on his entitlement on termination. When he was terminated, instead of challenging the contract’s validity, or attempting to negotiate a shorter period as most employees do, he obeyed it to the letter. But when the natural consequence of that was one year of unemployment, he sued MMV for damages for wrongful dismissal.

The employer attempted to argue that Dimmer, by remaining unemployed for the full year, had failed to mitigate his losses. MMV claimed its non-competition clause was never intended to keep a former employee from seeking employment with competitors but that somehow this information was never conveyed to Dimmer. One of MMV’s principals even testified he assumed the contract was unenforceable.

The court awarded Dimmer severance of one year taking into account the length of the non-competition agreement. “In my view, this agreement effectively eliminated any opportunity to obtain similar employment during that year,” Justice Moore of the Ontario Superior Court noted.

This outcome provides a sober lesson for employers who wish to insert lengthy restrictive covenants in their employment agreements. To obviate this potential repercussion, I recommend the following:

– The employment agreement should contain a provision limiting the amount of notice to which an employee is entitled on termination (but ensuring that notice is greater than the statutory minimum), to avoid the court linking the period of reasonable notice to the length of the restrictive covenant. If the period of notice is too unreasonable, you will be motivating a court to find its way around the non-competition agreement.

– Generally, you should limit the clause to “non-solicitation” instead of “non-competition” or “non-dealing” with the company’s customers. The latter two clauses are usually difficult for the employer to justify and the courts won’t enforce them if they consider a non-solicitation clause will provide adequate protection. A non-solicitation clause allows a former employee to mitigate their losses by looking for work in the same industry but still largely protects the employer’s base of existing and prospective customers.

– Where an employer requires a restrictive covenant, its duration should be limited to the time necessary to protect the employer’s interests. If the period is overly long, the court will strike it down and will not rewrite it to make it legally compliant, even if the contract invites it to do so.

This article originally appeared in the Financial Post.

Article by Howard Levitt

Levitt LLP