Restrictive Covenant Update

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There are several considerations that employers should be mindful of when attempting to enforce non-competition/non-solicitation obligations against former employees.

Two brothers, Jason and Jeffrey, worked for Computer Enhancement Corporation ("CEC"). Jeffrey secretly competed against CEC using inside knowledge while still employed and was fired. One month later, Jason quit without notice, but not before he and Jeffrey incorporated a business to compete against CEC.

The basic premise in these types of situation is that, in the absence of some contractual restriction or fiduciary or other duty at common law, a former employee is free to carry out his trade, even if that means competing with his former employer and doing business with his former employer's customers. The issue for the Court in this case was the determination of when and how such limitations arose.

During the course of their respective employment, both brothers had signed a non-competition/non-solicitation agreement. Jason, who was one of CEC's top salespersons, signed the agreement six months after the commencement of his employment.

Jeffrey signed an identical agreement when he was hired. Five years after the commencement of his employment, Jeffrey registered an unincorporated business named J.C. Options. Jeffrey used inside knowledge of CEC's bids to underbid the company and won half a dozen contracts before being discovered and fired. While Jason was still employed by CEC, he and his brother incorporated J.C. Options. A month after Jeffrey's departure, Jason quit without notice and sent an email to his former customers to advise them that he was resigning.

CEC alleged that both Jason and Jeffrey had violated their agreements before and after they left the company.

Consideration for Agreements Amending an Existing Employment Relationship

Jason argued that the agreement was void because he received no consideration when it was executed. Amendments to employment agreements require fresh consideration beyond the continuation of employment.

Charney J. found that there was no evidence that Jason had gained increased security of employment or any other consideration for agreeing to the clause six months into his employment. The agreement itself indicated that consideration in the sum of $10 was to be paid by each party to the other. Charney J. concluded that there was no actual consideration flowing to Jason because he had to immediately return the $10 he was given. He further found that "...such a straight exchange, regardless of the amount involved, is no consideration at all."[1] As a result, even if the parties had exchanged this symbolic $10 between them no consideration would have actually been given to Jason.

The Extent of an Employee's Fiduciary Duty against Competition and Solicitation Beyond Employment

Despite Jason having no contractual duty not to compete with CEC, it was argued that he still owed a common law fiduciary duty to his former employer not to solicit customers both during his employment and for a reasonable period following his resignation.

In order to determine his post-employment obligations, Charney J. considered whether or not Jason was a "key employee", despite not being a manager or officer. Charney J. found that Jason was a key employee because he was the top salesperson, the only contact to the company for most of its customers, and was given significant autonomy.

Enforceability of Non-Competition/Non-Solicitation Agreements

The defendants argued that the non-competition/non-solicitation clause in the employment agreement with Jeffrey was not enforceable because it was unreasonable. The Supreme Court of Canada has previously held that a restrictive covenant is prima facie unenforceable unless is shown to be reasonable and if the covenant is ambiguous, then it is unreasonable.

Charney J. found two of the clauses to be void and unenforceable. The first, that Jeffrey not "directly or indirectly engage in any company or firm which is a competitor", was determined to be overly broad. The second, which stated that Jeffrey may not "intentionally act in any manner that is detrimental" to CEC 's relationships with its customers, was considered vague and ambiguous. The section that prohibited solicitation itself was considered enforceable as a severable section from the entire clause.

Direct versus Indirect Solicitation

The issue of direct versus indirect solicitation of business also became an issue as both brothers claimed that customers would request bids. The Ontario Court of Appeal has previously held that the bid submitted in response to a public tender is not solicitation. Charney J. also recognized that accepting work from a former customer does not, on its own, constitute direct or indirect solicitation. It was found that there was a difference between "soliciting" and "accepting" business. In this case, accepting business was found to include submitting bids in response to customer' s request.

Conclusions

This case expands on some of the difficulties faced by employers when attempting to enforce non-competition/non-solicitation obligations against former employees. There are several considerations that employers should be mindful of:

- Consideration is particularly important in the context of non-competition/non-solicitation agreements when an employer is attempting to impose such terms after the employee has started employment. In this situation, an employer must consider "what is valid consideration".
- Even if a non-competition/non-solicitation agreement is not in place, a key employee may still have a fiduciary duty not to compete against their employer for a reasonable period following their resignation/termination.
- If a non-competition/non-solicitation obligation exists, indirect solicitation and the accepting of business may not violate that obligation.
- The language of non-competition/non-solicitation agreements should be tailored as much as possible and employers should not rely on overly broad clauses being enforced.

[1] *Ibid*, at para. 43.

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