Restrictive Covenants in an Employment Context

By Micheal Donsky

Just as there are different ways that people can work together, there are different problems that arise when they choose to go their separate ways.

One of the problems that can often arise is "ownership" of clients. Ownership is in quotations because, as a practical matter, nobody actually owns clients. The clients can go where they wish; however, both parties will want to do what they can to ensure that they are the direction chosen.

One of the ways in which an employer will try to protect the relationship with the clients is to require that an employee, as a condition of employment, enter into a form of restrictive covenant. A restrictive covenant is, in effect, exactly what it sounds like: a covenant, or agreement, that restricts some sort of activity.

There are, in an employment context, a variety of types of restrictive covenants that can be entered into, but for the purposes of protection of the client relationship, the main types are: Non Competition Clauses, Non-Solicitation Clauses, and Non-Acceptance Clauses.

A **Non-Competition Clause** is one where the employee agrees that, for some set period of time after the end of the employment relationship, the employee will not enter into a competitive business. Generally, such clauses have both geographic and temporal limitations. So, for example, you could agree not to enter into a competitive business for 12 months within 20 km of the employer's business.

While there are circumstances where a Non-Competition clause can be enforced in Ontario, they usually are not. Courts in Ontario generally consider restrictive covenants as contrary to public policy unless they can be somehow justified in the circumstances of the case. Non-competition clauses, as the most onerous of restrictive covenants, are generally not enforceable in Ontario if a lesser covenant – such as a Non-Solicitation Clause – would be sufficient. Even when they would otherwise be enforceable, non-competition clauses will not be enforced unless a court finds them to be minimally restrictive: that is they should not restrict the employee for any time period or over any area that is greater than reasonably necessary for the protection of the former employer.

In general, what is "too" restrictive is often a function of what type of clause it is, but the criteria are generally temporal and geographical.

To use an extreme geographical example, if you are in a business where most of the customers are from within the general area – say, within 10 kilometres of the business office – then a non-compete that prevented competition anywhere in the Western Hemisphere would be too broad.

Similarly, to show temporal limits, if you see a patient, on average, annually, then there might be good reason to prevent competition for 2 years – in effect, the current appointment plus the next one (to give the beneficiary of the restrictive covenant a chance to retain the client). On the other hand, with the same circumstances, a 10 year non-compete would be too much. Similarly, if you saw the patient every other week, a two-year non-compete would appear to be overkill and unnecessary.

A **Non-Solicitation Clause** is an agreement that the employee, after leaving the employer's business, will take no steps to solicit (influence or incite) someone to leave the former employer's business. Such clauses might apply to customers or clients of the business, or might apply to other employees of the business. Like non-competition clauses, these terms usually have both geographic and temporal limitations.

What is important about these clauses is that while the employee is not allowed to convince customers of the business to leave (where it is customer relationships that cannot be solicited), there is nothing stopping the former employee from accepting the customer of any person who chooses themselves to follow the former employee to their new place of business.

In essence, that loophole is one of the greatest weaknesses of non-solicitation clauses: it is difficult to prove that a customer or employee was solicited unless they actually admit that they were.

Non-Acceptance Clauses are intended to deal with that weakness in non-solicitation clauses: they prevent the former employee from accepting the business of customers of the former employer for some period of time.

In all such cases, the purpose of the restrictive covenant is to allow the employer to protect the relationship with the customer or other employee before the now departed former employee can attempt to take that good will for herself.

All of which makes a lot of sense if you are the employer. But what about the interest of the employee who deal with customers day to day and is often the person responsible for developing that relationship on behalf of the employer? What about the employee who joins an employer with a stable of their own customers?

The bargaining power is certainly on the side of the employer; it is relatively rare that an employee can pick and choose in advance all the terms under which he or she will work and employers generally are protective of their restrictive covenants. However, as counterbalance to that reality, the courts will generally only enforce restrictive covenants that are not unduly restrictive. As was stated by the BC Court of Appeal: "the law favours the granting of freedom to individuals to pursue economic advantage through mobility in employment." (Barton Insurance Brokers v. Irwin, 1999).

While an employee is, as a result, generally free to enter into competition with a former employer as soon as the employment ends, our Supreme Court has found that the parties are allowed to contractually modify that principle through a reasonable restrictive covenant. (Elsley Estate v. J.G. Collins Insurance, [1978] 2 S.C.R. 916)

Recent case law has started to recognize the fact that in many relationships, especially professional relationships, the client may feel at least as strong a relationship with the professional they deal with as with the company the professional works for. In concrete terms, while you might not care which teller you deal with at the bank, you probably care which dentist you deal with at the dental office.

Some recent case law has started to accept the idea that there is, to the extent anyone actually "owns" a client, a dual ownership of sorts. For example, in a recent Alberta decision dealing with ownership of clients as between a financial advisor and his or her firm, the court noted that "even though the clients are basically clients of the firm, their actual contact is the financial advisor and thus the relationship between the client and the financial advisor is the crux of the brokerage business.... [the] financial advisor is the primary contact with the client and ... he creates the 'goodwill' in the dynamic." (Soost v. Merrill Lynch, 2009 Alta. Q.B.)

A similar argument could likely be made regarding any professional service provider and her clients/patients/customers.

Because of that recognition of the advisor/employee's relationship with the clients, and despite the fact that (absent agreements to the contrary) courts have generally recognized that "ownership" of the clients resides with the employer, in this case the court held that "both the brokerage house as well as the financial advisor are entitled to compete to keep/attract the client. Indeed, the evidence before me demonstrates that a significant percentage of clients follow their financial advisor to his new brokerage house. Both the brokerage and the financial advisor are "free to compete" for the clients."

If an employee moves her business to a new employer and brings a stable of clients with her, it is worth contracting that "ownership" of those clients resides with her and does not pass to her employer unless the employer is prepared to pay something for that "book of business". If the employer does buy the book of business, then the employer will want some sort of restrictive covenant to ensure the employee doesn't leave and take the clients with her when she does go.

Similarly, when an employee joins an existing practice, the employer who owns the practice may want some assurance the employee won't join, raid the clients, and then leave. However, the employer should realize that the very qualities that make the employee an attractive employee, will likely also make the person an attractive service provider to the clients. The risk of lost clients is always there.

All of which suggests that the best course between employer and employees is one that recognizes the interest of both. Contracts should be prepared with a reasonable eye to the interest of both employer and employee.

After all, whatever is decided between the employer and the employee, the client still has the ultimate decision to choose their service provider. Protracted fights over the clients, especially if they spill over and involve the clients, usually result in a situation where the client will not deal with either of its former service providers.

Michael Donsky is a Partner at Fogler Rubinoff LLP in Toronto. He is an experienced civil litigator whose practice has a particular focus on broker liability litigation and employment law matters.

OPA Members win Ontario Community Action Award

OPA members **Doreen Sharpe** and **Mary Solomon** were recently awarded Ontario's Community Action Award by Lieutenant Governor David Onley.

Each year the Province of Ontario presents the Community Action Awards to people who are dedicated to promoting the acceptance and participation of persons with disabilities in their communities. The Community Action Awards are presented to persons with or without disabilities who have made a significant contribution to promoting access and equal opportunity for persons with disabilities, or who have shown commitment and dedication to developing the potential of persons with disabilities and improving their quality of life.

Congratulations to Doreen and Mary for their contributions to the citizens of Ontario!

OPA members Doreen Sharpe and Mary Solomon receive their Community Action Award from Lieutenant Governor David Onley.