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PROTECT YOUR BUSINESS PURCHASE WITH NON-COMPETITION AND NON-SOLICITATION PROMISES FROM THE VENDOR

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Introduction

In a recent, unanimous decision, the Supreme Court of Canada upheld five-year non-competition and non-solicitation provisions given by a vendor to a purchaser as part of an agreement for the sale of a crane rental business. Although the decision in *Payette v. Guay Inc.*, 2013 SCC 45, was rendered on an appeal from a Quebec court under the Civil Code of Quebec, it is an important decision for common law jurisdictions, like British Columbia, dealing with the circumstances in which a court is more likely to enforce restrictive covenants.

Facts

The purchaser was a crane rental company with over 20 locations across Quebec. It had expanded its market share by purchasing several small competitors over the years and had become the industry leader in its business. The vendors controlled several crane rental companies of their own and agreed to sell their business for \$26,000,000. To ensure a smooth transition in operations following this sale, the vendors agreed to work as consultants to the purchasers for six months. Thereafter, the purchasers were given the option of employing the vendors in the business.

The agreement of sale provided that the vendors were bound by five-year, non-competition and non-solicitation provisions in the crane rental business. The non-competition provision applied throughout the Province of Quebec. The non-solicitation provision, however, was not restricted to any particular geographic territory.

After the purchase and sale completed, the vendors became employees of the purchaser. A few years later, they were dismissed from their employment and started working for the purchaser's competitor.



The Decision

The purchaser sued to enforce the non-competition and non-solicitation provisions and sought an injunction compelling the vendors to comply with the restrictive covenants for the five-year post-employment period stipulated by the agreement. The Supreme Court of Canada upheld the decision of the Quebec Court of Appeal which granted a permanent injunction requiring the vendors to comply with the two restrictive covenants.

Important Distinction Between Contracts of Employment and Contracts for the Sale of a Business

The rules applicable to restrictive covenants relating to employment differ depending on whether the non-competition and non-solicitation provisions are linked to a contract for the sale of a business or to a contract of employment. Different rules apply in the context of a contract of employment because the employer-employee relationship is generally characterized by an imbalance of power at the time the employment contract is negotiated. For that reason, the purpose of the rules applicable to restrictive covenants in employment contracts is to protect the employee's right to use the knowledge and skills acquired during his employment by working for whomever and where ever he wishes.

In a vendor-purchaser relationship, however, there is generally no imbalance of power between the parties. For that reason, the law recognizes that parties negotiating the purchase and sale of assets have greater freedom to contract than do parties negotiating a contract of employment. These rules apply both in common law jurisdictions like British Columbia, and in the civil law of Quebec. In a commercial context, restrictive covenants are generally lawful unless it is shown that they are contrary to public policy because they are unreasonable.

Test for Reasonableness of Restrictive Covenants in Commercial Contracts

In the commercial context, a restrictive covenant is lawful unless it can be established that its scope is unreasonable. The reasonableness of a non-competition provision is measured by three factors: the term (i.e. length of time), the geographic territory and the scope of the activities to which it applies.

In commercial contracts, a five-year non-competition provision can be reasonable, whereas a five-year non-competition period in a pure employment contract, would almost never be considered reasonable.

In principal, the territory to which a non-competition covenant applies is limited to the geographic area in which the company carries on business. In the *Payette* case, however, even though the vast majority of the vendor's business was conducted in the Montreal area, the court considered the territory of Quebec was not



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too broad given the unique nature of the crane rental market. Cranes are mobile. They go where the construction sites are located. The activities of that type of business depended more on how construction sites were dispersed than on the company's place of business.

Non-solicitation provisions are generally more likely to be enforced than non-competition provisions, both in commercial contracts and in contracts of employment.

Although the geographic territory is an important factor in determining the reasonableness of a non-competition clause, there is no requirement for a territorial limitation in a non-solicitation clause. The courts recognize 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 provisions have generally become obsolete.

Summary

Courts will generally uphold non-competition provisions in commercial contracts involving the sale of a business because of practical considerations. A person seeking to sell his business might find himself with an unsalable commodity if denied the right to assure the purchaser that he, the vendor, would not later enter into competition.

A different situation arises, however, in the negotiation of contracts of employment where an imbalance of bargaining power may lead to oppression and a denial of the right of the employee to exploit, following termination of employment, in the public interest and in his own interest, the knowledge and skills he obtained during his employment. For that reason, the courts are far more likely to scrutinize and strike down non-competition provisions in contracts of employment, than in contracts for the sale of a business.

Any purchaser acquiring the business of a competitor should protect that business purchase by insisting on non-competition and non-solicitation provisions from the vendor.

