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Are Restrictive Covenants in Sale Agreements Enforceable?



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The Supreme Court of Canada recently addressed the issue of the enforceability of restrictive covenants where the purchaser of a business offered employment to the business's previous owners (*Payette v Guay Inc.* 2013 SCC 45). In this case, the Supreme Court of Canada put to rest a long-standing inconsistency in the law regarding how broad a restrictive covenant can be when it is entered into in the context of both an agreement for sale of a company and a subsequent employment contract for some of the vendor's primary employees.

Payette v Guay Inc. confirms that where an agreement for sale of a company gives rise to both a commercial contract and an employment contract, that context can be used to interpret the wording of the restrictive covenant. Specifically, the Court may apply the broader principles used to interpret such covenants where the parties have equal bargaining power (such as in the context of a commercial transaction) rather than the narrow interpretation typically applied in the employment context, where the unequal bargaining power of the parties requires narrow interpretations in favour of the employee.

In *Payette v Guay Inc.*, Payette had a controlling interest in a crane rental company that operated primarily in the Montreal area. Guay Inc. entered into an asset purchase agreement to purchase the company. The terms of the Agreement included a requirement that Payette remain a consultant of Guay Inc. for 6 months after closing, and contemplated employment with Guay Inc. thereafter. The Agreement also included a non-competition clause and a non-solicitation clause, both with a duration of 5 years past the cessation of employment with Guay Inc. The non-competition clause had a geographical scope that included the entire province of Quebec.

The Supreme Court of Canada unanimously held that notwithstanding the fact that Payette remained an employee of Guay Inc. for an additional 4 years after the termination of his mandatory consultancy, the terms of the restrictive covenant needed to be interpreted in the context of the agreement for sale, and on that basis held that both the geographical scope and the temporal limitations were reasonable,

as insufficient evidence had been adduced to the contrary.

Given this finding, it is now clear that in this context a restrictive covenant will be held to be reasonable unless it can be shown that it is broader than what is necessary to protect the legitimate interests of the parties to the agreement for sale. This must be determined on the specific facts. However, the courts in Alberta have shown a propensity to uphold the agreement of the parties unless there is strong evidence that there is a legitimate reason not to do so: see *Senos v Pacesetter Performance Drilling Ltd.* 2010 ABQB 533, *Ensign Drilling Inc. v Lundle* 2007 ABQB 357 and *Spartek Systems Inc. v Brown* 2014 ABQB 526.

Further, the Supreme Court of Canada in *Payette v. Guay Inc.* was willing to acknowledge the clause of the contract in which the parties expressly agreed that the covenants were reasonable. The Court affirmed that it is not bound by such an acknowledgment; however, the Court held that such a term is indicative of the reasonableness of the covenants (particularly where the parties are sophisticated parties acting on legal advice).

This case may signal a move toward a more liberal interpretation of restrictive covenants and an acknowledgment of the freedom of parties to contract based on their commercial interests. However, the Court's emphasis on the need to investigate the specific facts of each case also affirms a continuing requirement that a restrictive covenant must not be unnecessarily broad, and that it must be clearly tied to a broader commercial transaction to increase the likelihood of enforceability.

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