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# LABOUR & EMPLOYMENT UPDATE

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## "METROPOLITAN CITY OF VANCOUVER" FOUND TO BE UNCERTAIN AND AMBIGUOUS – SUPREME COURT OF CANADA RULES ON NON-COMPETITION AGREEMENT

*"An ambiguous restrictive covenant is by definition unreasonable and unenforceable"*

In its decision in Shafron v. KRG Insurance Brokers (Western) Inc., released on Friday, January 23, 2009, the Supreme Court of Canada considered whether the word "Metropolitan" was ambiguous, and therefore unenforceable when included in a non-competition agreement. This case is of significance, aside from the Court's general commentary about drafting restrictive covenants, but also because the word "Metropolitan" is often used, most people thinking it has a commonly understood meaning. Whether that it is the case, we now know it has no legal significance. The term "City of Vancouver" would have been the correct legal description.

**Facts:**

In 1987, Shafron sold his insurance agency to KRG. KRG renamed the agency KRG Western and in 1991, sold the agency to another party. KRG Western employed Shafron from 1987 to 2001 pursuant to a series of employment contracts. Each employment contract contained a similarly worded restrictive covenant in which Shafron agreed that for three years after leaving his employment for any reason other than termination without cause, he would not be employed in the business of insurance brokerage within the "Metropolitan City of Vancouver".

In January 2001, Shafron began working as an insurance salesman for another agency in Richmond. KRG Western commenced an action to enforce the restrictive covenant. It also claimed that Shafron had breached fiduciary and equitable obligations.

**Decisions of the lower Courts:**

The trial judge dismissed the action, finding that the term "Metropolitan City of Vancouver" in the restrictive covenant was not clear, certain or reasonable. He also found that Shafron owed no fiduciary duty to KRG Western.

The Court of Appeal set aside the decision. While agreeing that Shafron did not owe a fiduciary duty, it held that the restrictive covenant was enforceable. The court agreed that the term "Metropolitan City of Vancouver" was ambiguous. However, it applied the doctrine of notional severance and held that the term meant the City of Vancouver, the University of British Columbia endowment lands, Richmond and Burnaby.

**Decision of the Supreme Court of Canada:**

The Court of Appeal was wrong to substitute the phrase "City of Vancouver, the University of British Columbia endowment lands, Richmond and Burnaby" for "Metropolitan City of Vancouver". The term "Metropolitan City of Vancouver" was uncertain and ambiguous. Nothing demonstrated the parties had, at the time of making the agreement, a mutual understanding as to what geographic area the restrictive covenant covered. Therefore, it was inappropriate for the Court of Appeal to re-write the covenant.

Restrictive covenants generally are restraints of trade and contrary to public policy. Freedom to contract, however, requires an exception for reasonable restrictive covenants. Normally, the reasonableness of a covenant will be determined by its geographic and temporal scope as well as the extent of the activity sought to be prohibited. Reasonableness cannot be determined if a covenant is ambiguous in the sense that what is prohibited is not clear as to activity, time, or geography. An ambiguous restrictive covenant is by definition unreasonable and unenforceable.

The onus is on the party seeking to enforce the restrictive covenant to show that it is reasonable and a party seeking to enforce an ambiguous covenant will be unable to demonstrate reasonableness.

Restrictive covenants in employment contracts are scrutinized more rigorously than restrictive covenants in a sale of a business because there is often an imbalance in power between employees and employers and because a sale of a business often involves a payment for goodwill whereas no similar payment is made to an employee leaving his or her employment. As the restrictive covenant here arose in an employment contract, it attracted a higher standard of scrutiny.

The Supreme Court also considered whether it could re-write the contract for the parties so that it could arrive at an agreement that could be enforced. In doing so, it considered the interpretive philosophies of "notional severance" and "blue-pencil severance". Notional severance means the court reads down the contractual provision so as to make it legal and enforceable. Blue pencil severance means to remove part of a contractual provision so that the rest is enforceable.

Notional severance is not an appropriate mechanism to cure a defective restrictive covenant. Notional severance may be available where an objective bright line test exists to distinguish what is legal from what is not; however, there is no objective bright line test for reasonableness. Applying notional severance simply amounts to a court re-writing a covenant in a manner that it subjectively considers reasonable. Employers should not be invited to draft overly broad restrictive covenants with the prospect that the court will sever the unreasonable parts or read down the covenant to what the court considers reasonable. This would change the risks assumed by the

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parties and inappropriately increase the risk that an employee will be forced to abide by an unreasonable covenant. The Court of Appeal should not have attempted to resolve the ambiguity in this case by reading down the restrictive covenant according to its own notion of reasonableness and what it thought that the parties might have intended.

Blue pencil severance may be resorted to sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purport of the restrictive covenant. Blue pencil severance cannot be applied to remove the word "Metropolitan" from the restrictive covenant in this case because it is not merely a trivial part of the covenant agreed to by the parties. There is no evidence that the parties unquestioningly would have agreed to remove the word "Metropolitan" without varying any other terms of the contract or otherwise changing the bargain.

*"Employers should not be invited to draft overly broad restrictive covenants"*

Rectification cannot be invoked to resolve the ambiguity in this case. Rectification is used to restore what the parties' agreement actually was, were it not for the error in the written agreement. Here, there was no indication that the parties agreed on something and then mistakenly included something else in the written contract. Rather, they used an ambiguous term in the contract. KRG Western could point to no prior agreement, written or oral, that explained the term "Metropolitan City of Vancouver.

**Implications for Employers:**

Shafron shows again the potential problems caused by using template agreements for every situation, with the consequent lack of thought as to what specific restrictions will be placed on an employee, and how those restrictions are expressed.

Particularly in the case of a non-competition agreement, employers should consider the following:

1. Is the agreement being drafted for the employee in question? While there is nothing wrong with starting with a precedent, each agreement should be tailored to the specific circumstances

2. Each restrictive covenant must be reasonable in terms of:

    (a) geographic scope;

    (b) length of time of the restriction; and

    (c) the scope of the business covered by the restriction.

3. Be wary of commonly used words like "Metropolitan", which for Vancouver (in my understanding) is used to refer to the City of Vancouver itself, as opposed to Vancouver's adjoining communities, which are separate cities by themselves. If, as in this case, you want to prevent a former employee from crossing out of Vancouver to Surrey or Richmond, then you must specifically say so. The phrase suggested by the Court of Appeal would have accomplished that purpose.

4. Be very specific when describing the geographic location, and the nature of the business. As we saw in the Shafron case, the phrase “Metropolitan City of Vancouver” was found to be ambiguous. The same can happen if the employer’s business is not specifically defined.

5. Be wary of “step-down” clauses. These are clauses that say, for example, “two years in Western Canada but, if that is not reasonable, then 18 months in Alberta”, and if that is not reasonable then 12 months in Calgary”.

6. Remember that Canadian courts are very reluctant to make contracts for the parties that they have not made for themselves, and reluctant to enforce restrictive covenants. If you as an employer do not make certain the scope of the restriction is clearly spelled out, and then go to Court to ask for the Court to read the restriction in a reasonable light, then enforce it, you are likely to be disappointed. The Court is looking for an excuse to rule restrictive covenants unenforceable. Ambiguity provides that excuse.

7. Don’t overreach. An enforceable 12 month restriction is a lot better than an unenforceable 18 month or two year restriction. Get up-to-date legal advice as to what is reasonable in the circumstances.






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