Non-Competition and Non-Solicitation

Restraining Trade
The Legal Way

By Albert S. Frank, LL.B.

Given our general hostility towards monopolies and friendliness towards unrestrained competition, both in our general social attitudes and in our laws, it might surprise you to know that under some circumstances the Courts will uphold contracts that limit competition.

Covenants in Restraint of Trade

Contracts can seek to restrain competition in various ways, including for example by including provisions in restraint of trade that prohibit:

- dealing with existing customers of a business;

- carrying on a certain type of business in a certain geographical area for a certain time period;

- carrying on a certain type of business anywhere in the world for a certain time period.

But will the Courts uphold these contracts? There is a collision between two competing values in the law – on the one side, the sanctity of a clear contract between equals,

and on the other side, the law's long-standing aversion to contracts that attempt to restrict competition.

The general rule is that covenants (contracts) in restraint of trade are void, and therefore unenforceable. This general rule has exceptions: a restraint of trade may be valid – and therefore enforceable – if it is reasonable in the interests of the contracting parties and also reasonable in the public interest. Restraints of trade are treated with suspicion, not with automatic condemnation.

Non-Competition vs. Non-Solicitation

Non-competition clauses typically restrain a person from competing in a certain geographical area for a certain time. They restrain such competition by prohibiting such business not only with existing customers, but also with anyone else within the area and the time period. A non solicitation clause, on the other hand, would typically only prevent one from seeking to do business with the existing customers or clients.

So in an employment situation a departing employee would only be prevented by a non-solicitation clause from soliciting the customers of his or her previous employer. A non-competition clause on the other hand does more than merely attempt to protect the employer's client or customer base; it attempts to keep the former employee out of the business.

The Court of Appeal for Ontario stressed, in the year 2000 case of ***Lyons v. Multari***, (2000) 50 O.R. (3d) 526, that the Courts will generally refuse to enforce a non competition clause if a non-solicitation clause would adequately protect the employer's interests.

Nevertheless, in exceptional cases the harm that could be done by allowing the competition would be so great that a simple non-solicitation clause would not suffice. In such cases the Courts will uphold a non-competition clause against a departing employee. For example, see the Supreme Court of Canada decision in ***Elsley v. J.G. Collins Insurance Agencies Ltd***., [1978] 2 S.C.R. 916.

Sale of a Business vs. Employment

Non-competition and non-solicitation clauses usually arise in one of two contexts: first, in the sale of a business where the purchaser wants to ensure that the vendor – or the vendor's owner – will not set up a new rival business; and, second, in an employment relationship where the employer wishes to prevent the departing employee from establishing, or working for, a rival business.

The Courts treat these two contexts differently: they are likelier to uphold a restraint of trade in a sale of a business context than in an employment context.

One reason is that it would be difficult to

get a reasonable price on selling a business if the purchaser could not be confident that the vendor would not then set up in competition. The business could be totally unsaleable without such confidence. Thus allowing a restraint is in the interests of vendors and purchasers generally. Another reason is that a vendor and purchaser are likely to have reasonably equal bargaining power but an employer will often have greater bargaining power than the employee.

Injunctions

A business can be devastated long before a lawsuit can reach the trial stage. A Judgment could be uncollectible against an impecunious defendant. In such circumstances, what good is a valid covenant?

Sometimes the Courts will, long before trial, grant an interlocutory injunction restraining breaches of the covenant in issue. The hope would then be to settle the case long before trial, which often happens after an interim injunction has been granted, or to get the injunction extended at trial.

In 1994 the Supreme Court of Canada, in the case of ***RJR MacDonald Inc. v. Canada (Attorney General)***, [1994] 1 S.C.R. 311 set out the test for the granting of an interlocutory injunction. The test has three parts:

1) Is there a serious question to be tried?
2) Will the applicant suffer irreparable harm if the injunction is not granted?

3) Which party will suffer the greater harm from granting or refusing the remedy pending a decision on the merits? [This is often called the "balance of convenience."]

In my own experience, injunction hearings often center on the balance of convenience.

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The above article first appeared in the Mid September, 2002 issue of ***The Bottom Line***.

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Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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