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The Perils of Inserting Non-Solicitation and Non-Competition Clauses Into Your Employment Agreements

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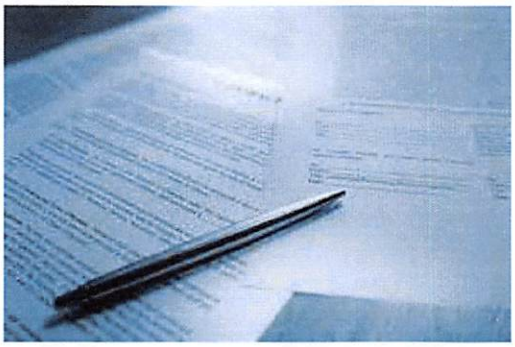

For many years, it has been standard practice in some industries to insert non-solicitation clauses, and even non-competition clauses, into the employment agreements of senior managerial and key non-managerial employees. Employers invariably assume that such clauses provide their businesses with increased legal protection in the immediate aftermath of a termination, by prohibiting employees from approaching customers or working for direct competitors.

Alan Riddell

Unfortunately, that assumption is frequently wrong. Far from protecting your business, such non-solicitation and non-competition clauses can often have the direct opposite effect. Not only are those clauses increasingly held to be unenforceable when challenged in court; they can also very significantly increase your firm's liability when you later seek to remove the affected employees from your workforce.

Unbeknownst to many HR managers, several recent Canadian court decisions have held that the existence of a non-competition or non-solicitation clause in an employment agreement can dramatically increase the pay in lieu of notice owing to the employee when he or she is ultimately terminated.

Kyle Van Schie

The upshot of these recent court decisions is that when your organization inserts such clauses into its employment agreements, it may unwittingly be increasing – very significantly – the financial burden which it must shoulder when the employee eventually leaves the company. That added financial burden frequently far outweighs any real financial protections which the non-solicitation clause provides to your organization, with the result that the insertion of the clause may paradoxically harm rather than protect your organization's long-term business interests.

In many cases, whenever an employer asks an employee to sign an employment agreement containing a 12-month non-competition or non-solicitation clause, and then terminates her employment thereafter, the courts often assess the employee's notice at roughly equal to the 12 month time period prescribed in those clauses. For example, in *Tremblett v. Imperial Life Assurance Co. of Canada*, the court awarded a whopping 12 months' notice to a sales manager with merely 3 years of service on the grounds that he had signed a 12 month non-solicitation agreement. Similarly, in *Woodward v. Dubois Chemicals*, the court also awarded a full 12 months' notice to a young non-managerial employee, with 10 years' service, because he too had signed a 12 month restrictive covenant. In yet another example - *Ostrow v. Abacus Management Corporation Mergers and Acquisitions*, where the employee was dismissed after less than a year of employment, the court nonetheless assessed the notice period for that very short-serving employee at 6 months because of a 6 month non-competition clause in his employment contract.

The rationale underlying these recent decisions is that non-solicitation and non-competition clauses significantly reduce the ability of dismissed employees to obtain new employment, thereby increasing the time which they need to do so. Any employee who could ordinarily be expected to find a new job within 3 months will likely take much longer to find that job if he is prevented from joining a competitor or contacting former clients.

Once you terminate the employment of an employee who has a non-solicitation or non-competition clause in his or her employment agreement, there is very little that can be done to avoid the enhanced notice which the courts are now saying that you must pay. It would appear that an employer's subsequent waiver of the non-solicitation or non-competition clause, to assist the dismissed employee's attempts to secure new paid employment elsewhere, will have little or no impact on the

enhanced notice which it owes the employee. By way of illustration, in *Ostrow and in Watson v. Moore Corporation Ltd.*, the British Columbia Court of Appeal held that where the employer elected not to enforce the non-competition clause, or the clause itself was deemed to be unenforceable, thereby removing all barriers to the employee's reemployment elsewhere, the employer was still required to pay the same enhanced notice as if the clause was being rigorously enforced. In both cases, the Court assessed the notice period as being at least the full duration of the non-competition or non-solicitation clause (6 months in Ostrow, and 18 months in Watson).

At first blush, both these decisions are surprising because a waived or unenforceable non-solicitation or non-competition clause clearly facilitates the dismissed employee's ability to secure new paid employment, and thereby would appear to eliminate the entire rationale for increasing the employee's notice period. In Ostrow and Watson, the Court appeared to reject this logic, on the theory that notice periods are to be assessed according to the circumstances that existed on the date of termination itself, and should not take into account subsequent conduct, after that date, which might facilitate the dismissed employee's later attempts to secure new paid employment.

In light of these recent developments, legally sophisticated employers should now think very carefully before inserting non-competition or non-solicitation clauses into their employment agreements.

If you wish to continue using non-solicitation or non-competition clauses in your employment agreements with your employees, then you should take particular care to ensure that those employment agreements contain carefully crafted, and up-to-date, termination clauses that validly restrict the Common Law notice that must be paid to employees when they are terminated.

In the last few years, a series of Ontario decisions have ruled that the wording of many such termination clauses are now invalid, on the grounds that they appear to have the potential to conflict with existing employment standards legislation. The courts now hold such termination clauses to be invalid even when the potential conflict is abstract rather than real. They also hold that where such termination clauses are potentially in conflict with the legislation, the employer will be ordered to pay its employees full Common Law notice, sometimes equalling more than a month per year of service that the employee has worked for the employer. Invariably, such decisions came as a very nasty shock to the affected employers, who believed that their longstanding termination clauses empowered them to terminate their employees, without cause, simply upon paying them only a few weeks of statutory termination pay.

In the wake of these recent Ontario decisions, all prudent employers should now be taking urgent steps to avoid such nasty – and expensive – surprises by immediately ensuring that the termination clauses in all their employment agreements with their current employees are carefully reviewed by an employment lawyer who is well-acquainted with this recent Ontario caselaw, and who can revise the clauses to make them fully compliant with that caselaw.

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