BANKING ON CORPORATE

BY NEILL MAY

Legally lost in translation

Every once in a while I am reminded that principles and concepts intuitive and comprehensible to lawyers may be far less clear to many non-lawyers. Sometimes the intrusion of legal principles into the mainstream is well-publicized, such as the recent widespread public discussion about the finding that Richard Kachkar was not criminally responsible for the death of Toronto policeman Sgt. Ryan Russell. Other examples are more subtle. A sports club that prohibits certain risky activities erects a sign warning about the dangers of those activities, but without strict prohibition language. To most lawyers the reasoning is apparent — if the signage prohibited the activity but the club didn't police it, then the club would be responsible for adverse consequences — but it is difficult to argue with the lay perspective that if an activity is prohibited, the signs should say so.

Non-competition covenants are one of those areas of law that develops its own logic, from which it is helpful to step back occasionally. The starting point, which itself would likely be odd for most without legal training, is that a great deal of time is spent negotiating non-competition contracts even though non-competition covenants are *prima facie* not enforceable (because they interfere with individual liberty and the exercise of trade). The counter-intuitive starting point, however, is only the tip of the iceberg of confusion.

Recently, the Ontario Court of Appeal provided some guidance on the enforceability of non-competition covenants in *Martin v. ConCreate USL Limited Partnership*. Martin had been employed by ConCreate USL Ltd. for 20 years, eventually acquiring a minority interest in it and a related business, Steel Design & Fabricators Ltd. In connection with the sale of the businesses, Martin retained a minority interest in the acquiror limited partnership, and entered into agreements containing non-competition and non-solicitation covenants. Martin's employment was terminated six months after the sale transaction. Eight days later, he established a company that competed with SDF and employed former ConCreate employees. ConCreate and SDF argued successfully at trial that Martin had breached his agreements, and Martin appealed to the Court of Appeal.

Some of the issues relevant to the enforceability of the covenant are clear from the facts. On one hand, the restrictive covenants were provided in connection with the sale of a business; covenants given in that context tend to be more easily enforced than employment agreement covenants, particularly where the parties have equal bargaining power and are represented by counsel. On the other hand, the broad scope of the restrictive covenants is problematic from an enforceability perspective; for example, restrictive covenants prohibited Martin from engaging in a range of activities that included activities in which ConCreate and SDF did not even engage at the time of the sale transaction (and the Court of Appeal determined the scope of the prohibited activities was overly broad, going beyond what was required to protect the companies' goodwill).

The focal point of the decision, however, was the duration of the covenants, which were effective for 24 months from the time Martin disposed of his partnership interests. Under the agreements Martin could not sell his interests without obtaining the consent of, among others, ConCreate, SDF, and any lenders and bonding companies engaged by them from time to time.

Because the restrictive covenants had no fixed, outside limit, they were found to be entirely unreasonable and therefore unenforceable. The Court of Appeal noted the duration of the covenants was dependent on a future disposition of Martin's interests, which itself was conditional on the consent of unascertainable third parties that owed no duty to Martin to act promptly or reasonably. In fact, such parties may have had an interest in withholding consent in order to limit Martin's competitive activities.

Reverting to the starting point, the Court of Appeal's approach is that the enforceability of restrictive covenants will depend on the reasonableness of the covenants, and will be subject to a lower degree of scrutiny if entered into in connection with the sale of a business.

What is notable from *Martin* is the sheer fragility of restrictive covenants. The Court of Appeal determined Martin's covenants were unenforceable because of their uncertain duration. But the alleged competitive activity commenced a mere eight days after termination of Martin's employment. That outcome is difficult to reconcile with an assessment of the parties' objective expectations.

For lawyers, the lesson learned is that great care must be taken to fix clear, certain, and reasonable limits on restrictive covenants. Why the failure to do so means the covenant is entirely unenforceable, even when there is competitive activity that seems clearly within its intended scope, is understandably confusing to non-lawyers. This has led me to consider developing a Rosetta Stone-type program for legalese. It is entirely unclear that anyone would purchase it, but it should not take much time to develop a program that simply advises students not to bother, since the language of legal principles is far too confusing to explain or understand.

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