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Interpreting Restrictive Covenants in Commercial and Employment Agreements

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Case Commented On: *Ruel v Rebonne*, [2023 ABCA 156 \(CanLII\)](#)

Restrictive covenants are usually found in two types of agreements: commercial agreements for the purchase of a business and employment agreements. In commercial agreements, these clauses protect the purchaser; after having made a substantial investment, the purchaser can build ties with customers without being concerned about the vendor setting up a competing business for a specified time. In employment agreements, they protect the employer's interests.

Courts will enforce these covenants in both types of agreements as long as they are reasonable, though the reasonableness test is applied with more scrutiny in the employment context. The reasonableness of the covenant is determined by the activity prohibited, and by its temporal and geographical scope.

Ruel v Rebonne, [2023 ABCA 156 \(CanLII\)](#) [*Rebonne CA*] is an appeal from a decision awarding damages to the respondent, Darren Ruel, for breach of a non-competition clause in an agreement for the sale of a business. The Court of Appeal upheld the trial judge's determination that the clause, which was found to be reasonable, was breached, and the expectation damages granted for breach of the clause. It allowed the appeal with respect to damages for mental distress.

This post will address the interpretation of the restrictive covenant.

Facts

The facts in this case are straightforward. The respondent, Darren Ruel, purchased a home décor business, Down the Beaten Path [DBP], from the appellant, Alexander Rebonne and his business partner. DBP imported home décor items from Mexico to distribute to customers in Canada.

The sale agreement contained a non-competition clause prohibiting the appellant from competing with DBP for 5 years. The clause also prohibited the appellant from the following: 1) soliciting customers of the business; 2) providing goods or services to customers of the business that the business could provide; and 3) acting in a way that could be detrimental to the relationships between DBP and its customers (*Rebonne CA* at para 3).

After Ruel purchased the business, Rebonne continued working there to assist in the transition of ownership. Ruel eventually hired Rebonne as a commissioned salesperson for the business. However, their relations soured by 2017 and Rebonne ceased working at the business. At that

point, he started working with another company, Mood Dekor, which he had incorporated shortly after the sale of his business to Ruel (*Rebonne CA* at para 6).

The evidence showed that Mood Dekor essentially carried on the same business as DBP. Specifically, it showed that it used the same suppliers, and purchased the same or substantially similar product as DBP (*Rebonne CA* at para 6). It also showed that Rebonne was selling the products to the Canadian customers of DBP (*Rebonne CA* at para 13).

At trial, Justice Robert W. Armstrong found that the non-competition clause was an essential part of the sales agreement, as Rebonne recognized that “the biggest threat to the ongoing success of DBP was other companies doing what DBP was doing and selling to his Canadian clients” (*Ruel v Rebonne*, [2022 ABQB 271 \(CanLII\)](#) [*Rebonne QB*] at para 42). He awarded the respondent damages for breach of contract and for mental distress.

Issues re non-competition clause

1. Did the trial judge err in finding the non-competition clause in the agreement enforceable?
2. Did the trial judge err in finding that the appellant had breached the non-competition clause by making sales to customers of DBP?

Decision

1. Did the trial judge err in finding the non-competition clause in the agreement enforceable?

The Court of Appeal noted that the validity of a non-competition clause is a question of law and depends on whether its scope is reasonable (at para 10). It found that the trial judge had applied the correct legal test, that the clause was an essential term of the deal, and that the clause was necessary for protecting the respondent’s legitimate interest in maintaining the value of his business (at para 11). Finding no error of law, it dismissed this ground of appeal.

2. Did the trial judge err in finding that the appellant had breached the non-competition clause by making sales to customers of DBP?

The appellant argued that the trial judge had erred in finding he had breached the non-competition clause, as the sales he had made at trade shows in the United States had not occurred “in Canada”, and the non-competition clause only restricted sales “in Canada” (*Rebonne CA* at para 12). The trial judge had found that Mood Dekor’s operations and sales were not restricted to the United States, that it had operated in Canada and sold products to Canadian customers of DBP. As these were factual findings, the trial judge is entitled to deference and the Court of Appeal found that the appellant had failed to identify a reviewable error in the judge’s interpretation of the clause (*Rebonne CA* at para 13).

Analysis

In this analysis, I will address when a non-competition clause will be found to be unreasonable.

Non-competition clauses, general principles

Non-competition clauses, or restrictive covenants, are typically found in employment contracts and agreements for the sale of businesses. They prevent employees from competing with former employers and prevent vendors from competing with purchasers. These clauses raise public policy issues, as they pit freedom of contract against public policy principles against restraint of trade.

The law deals with these clauses in several ways. There is legislation governing monopolies and antitrust, but the common law still governs contracts in which the restraint is voluntarily expressed. These covenants remain contrary to public policy at common law and are *prima facie* unenforceable, but there is now an exception to the general rule against restraint of trade, namely that courts will enforce these covenants as long as they are reasonable (*Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co*, [1894] AC 535 at 565).

The reasonableness of the clause is determined by the “extent of the activity sought to be prohibited and its temporal and geographical scope” (*Chhina v Rebecca L Darnell Law Corporation*, [2021 BCCA 430 \(CanLII\)](#); Waddams et al, *Cases and Materials on Contracts, Seventh Edition* (Toronto: Emond) 2023 at 598). The extent of the activity prohibited by the clause is also considered (*Shafron v KRG Insurance Brokers (Western) Inc*, [2009 SCC 6 \(CanLII\)](#) [*Shafron*] at para 26). Generally, an ambiguous covenant is *prima facie* unreasonable “because the party seeking enforcement will be unable to demonstrate reasonableness in the face of ambiguity” (*Shafron* at para 27).

There are different considerations when these covenants govern employment contracts than agreements for the sale of businesses. Agreements for the sale of businesses typically include the sale of goodwill, which requires the vendor to refrain from carrying on the same business with the same customers. In other words, the clause is necessary to protect the business. As Dickson J said in *Elsley v JG Collins Insurance Agencies Ltd*, [1978 CanLII 7 \(SCC\)](#), “[a] person seeking to sell his business might find himself with an unsaleable commodity if denied the right to assure the purchaser that he, the vendor, would not later enter into competition” (at 924).

A clause will be found to be reasonable in a commercial context if it is “limited, as to its term and to the territory and activity to which it applies, to whatever is necessary for the protection of the legitimate interests of the party in whose favour it was granted” (*Payette v Guay inc*, [2013 SCC 45 \(CanLII\)](#) [*Payette*] at para 61). The court will consider factors such as sale price, the nature of the business’ activities, the parties’ experience and expertise, and whether the parties had access to legal counsel and other professionals.

A covenant in restraint of trade in an employment contract on the other hand does not include a payment for goodwill. Also, the imbalance of bargaining power creates the potential for exploitation. Therefore, to protect the employee, courts will apply a more rigorous analysis of these clauses when they are found in employment contracts. As Justice Marshall Rothstein said in *Shafron*, “[t]he absence of payment for goodwill as well as the generally accepted imbalance in

power between employee and employer justifies more rigorous scrutiny of restrictive covenants in employment contracts compared to those in contracts for the sale of a business” (at para 23).

It is not always clear whether a restrictive covenant is linked to an employment contract or an agreement for the sale of a business, and the issue is open to debate (see, for example, in relation to franchise agreements: *MEDIchair LP v DME Medequip Inc*, [2016 ONCA 168 \(CanLII\)](#); *Garcha Bros Meat Shop Ltd v Singh*, [2022 BCCA 36 \(CanLII\)](#).) On this issue, the Supreme Court has said that it is important to “clearly identify the reason why the covenant was entered into” and went on to maintain that the “bargain” reached by the parties “must be considered in light of the wording of the obligations and the circumstances in which they were agreed upon” (*Payette* at para 45).

Application

At trial, the defendant argued that the court should apply the interpretive principles relating to employment contracts to the agreement. Armstrong J disagreed, finding that the contract was for the purchase and sale of a business. He also found that the parties had substantially equal bargaining power and both had legal counsel available to them during negotiations (*Rebonne* QB at para 54). For that reason, he applied the less restrictive interpretation reserved for commercial contracts. He found that the clause was clearly restricted in terms of geography and time, and that there was no evidence that the clause unfairly restricted the vendor’s ability to earn an income. He therefore found the clause to be reasonable (*Rebonne* QB at para 66). The Court of Appeal upheld these findings.

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