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Wolf in Sheep's Clothing: Creative Non-Competition Clauses

Introduction

Non-competition clauses are hardly a rarity in employment contracts. The classic non-competition clause seeks to protect the business of an employer by prohibiting a former employee from, generally speaking, competing with the employer once the employment relationship is terminated.

It is well-established that courts are unsympathetic towards non-competition clauses. It has been recognized under the doctrine of restraint of trade that non-competition clauses are contrary to public policy, since they "interfere with individual liberty of action and because the exercise of trade should be encouraged and should be free"[1]. As a result, non-competition clauses are prima facie unenforceable, unless the party trying to enforce the clause is able to demonstrate that it is reasonable. In *Aurum Ceramic Dental Laboratories Ltd. v Hwang* ("**Aurum**"), the Court summarized the criteria to be met to find a non-competition clause reasonable:

(a) the clause protects a legitimate proprietary interest of the employer;

(b) the restraint is reasonable between the parties in terms of:

  (i) temporal length;

  (ii) spatial area covered;

  (iii) nature of activities prohibited; and

  (iv) overall fairness;

(c) the terms of the restraint are clear, certain and not vague; and

(d) the restraint is reasonable in terms of the public interest with the onus on the party seeking to strike out the restraint.[2]

Failure to meet any one of the criteria above renders a non-competition clause unenforceable. However, until recently, the state of the law was ambiguous as to whether more nuanced clauses would even be considered non-competition clauses, and therefore whether or not such clauses could avoid the reasonableness test completely. For example, where a clause is not prohibitory *per se*, but instead imposes some other burden on the employee for competing, it was unclear whether it would be considered a non-com petition clause at all. The BC Court of Appeal recently addressed this issue in *Rhebergen v Creston Veterinary Clinic Ltd.* ("**Rhebergen**"), and clarified that a creative non-competition clause is still a restraint of trade. [3]

The Facts of Rhebergen

Rhebergen involved an employee, Dr. Stephanie Rhebergen, and her employer, Creston Veterinary Clinic ("**CVC**"). CVC is exceptionally isolated in that the closest clinics to CVC are 60 miles away and require a trip over the Canada-US border. The majority of CVC's business is drawn from a handful of dairy farms located in the Creston, British Columbia area.

As a newly licenced veterinarian, Dr. Rhebergen decided to enter into an associate agreement with CVC, wherein she would be paid to work with CVC for three years. The agreement provided that Dr. Rhebergen would be paid $65,000 for each of the three years. It also stated that Dr. Rhebergen would have to pay CVC if, within three years after the agreement was terminated, she set up practice in Creston, or within a 25 mile radius

of CVC's place of business in Creston (the "**Clause**"). Specifically, Dr. Rhebergen would have to pay $150,000 if her practice was set up within one year of terminating the agreement, $120,000 if her practice was set up within two years, and $90,000 if it was set up within three years.

A little over a year into the agreement, differences arose between Dr. Rhebergen and CVC, and the agreement was terminated. A few months later, Dr. Rhebergen sought a declaration that the Clause was unenforceable, so that she could "set up a mobile dairy veterinary practice in Creston and vicinity".

Summary of Trial Decision

Mr. Justice Betton gave brief reasons and found that the Clause was in fact a non-competition clause, even though it did not directly prohibit Dr. Rhebergen from competing. The judge then applied the criteria from Aurum and found that the Clause did not meet the test for reasonableness because it was ambiguous, and therefore unenforceable. CVC appealed the decision, including appealing the finding that the Clause constituted a restraint of trade to begin with.

The Court of Appeal

Although the majority of the Court allowed the appeal, the minority and majority only differed on whether the Clause met the criteria for reasonableness. Notably, the majority of the Court of Appeal endorsed Mr. Justice Lowry's reasoning that the Clause was indeed a non-competition clause.

The decision of Mr. Justice Lowry is illuminating, as it includes an extensive review of the English and Canadian authorities regarding whether a clause is a restraint of trade or not. In reviewing the jurisprudence, Mr. Justice Lowry commented that two strands of authority have been established by modern jurisprudence: the "formalist" approach and the "functionalist" approach. The formalist approach was relied on by CVC to argue that because the Clause does not prohibit Dr. Rhebergen from practicing outright, it cannot be a non-competition clause.

Mr. Justice Lowry noted that this approach requires a clause to be structured as a prohibition in order to constitute a restraint of trade. Under this view, clauses that simply impose a burden on the employee cannot be non-competition clauses. This may be counterintuitive, as "mere disincentives to post-employment competition are not sufficient to trigger the doctrine, even if those disincentives operate as effectively at dissuading competitive conduct and participation in the marketplace as a prohibition".[4] In conducting a review of the various authorities, Mr. Justice Lowry noted that the jurisprudence in Ontario favours the formalist approach.

The functionalist approach, on the other hand, asks whether "the clause at issue attempts to, or effectively does, restrain trade, in which case it will be captured by the doctrine and subjected to reasonableness scrutiny".[5] Mr. Justice Lowry noted that the functionalist approach has been widely accepted in English law, and that it is clear that a strict prohibition is not required for the doctrine of restraint of trade to apply. Mr. Justice Lowry then went on to determine that the functionalist approach is the preferred approach:

> In my view, the functionalist approach established in English law is to be preferred as the legal basis for determining whether clauses that burden employees with financial consequences, whether by payment or forfeiture, they would not otherwise have for engaging in post-employment competition constitute a restraint of trade. In the words of Lord Wilberforce, it is a matter of the effect of the clause in practice over its form. [6]

In applying this reasoning to the Clause, Mr. Justice Lowry found that it was a non-competition clause because "it compromises the opportunity to compete with the clinic Dr. Rhebergen would otherwise have".[7] The majority agreed with Mr. Justice Lowry's finding that the Clause was a non-competition clause, and the Court of Appeal unanimously accepted that the functionalist approach governs in British Columbia.

Comments

Although the Clause in *Rhebergen* was ultimately allowed to stand by the majority, the decision and the unequivocal adoption of the functionalist approach has implications for employers.

For one, the BC Court of Appeal has now made it clear that it will be the effect and not the form of the clause which will be determinative. Employers intending to restrain the post-employment activities of their employees will not be able to disguise the proverbial wolf in sheep's clothing – a non-competition clause by any other name will still be unenforceable if it is unreasonable.

A second possible effect of *Rhebergen* is that the functionalist approach will capture a larger range of restrictive clauses. Recall that the test under the functionalist approach captures even those clauses that "attempt to" restrain trade. Although only time will tell exactly what type of clause this will apply to, proactive employers will want to think carefully about and exercise caution in imposing post-employment burdens on employees, lest they be deemed non-competition clauses.

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[1] *Shafron v KRG Insurance Brokers (Western) Inc.* 2009 SCC 6 at para 6
[2] *Aurum Ceramic Dental Laboratories Ltd. v Hwang* (1998) 77 A.C.W.S. (3d) 161 (BC SC) ("Aurum") at para 11
[3] *Rhebergen v Creston Veterinary Clinic Ltd.,* 2014 BCCA 97 ("Rhebergen")
[4] *Ibid*, at para 29
[5] *Ibid*
[6] *Ibid*, at para 42
[7] I*bid*, at para 43