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# Covenants not to compete in common law

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# Covenants not to compete in common law

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Yvon MARCOUX \*

	Pages
<b>Introduction</b> .....	252
<b>Part I – Validity of covenants not to compete</b> .....	255
<b>Chap. I – Historical survey of the law</b> .....	255
<b>Chap. II – The modern law</b> .....	258
<b>A. Substantive requirements</b> .....	259
1 – <b>Existence of a covenantee's interest to protect</b> ...	259
2 – <b>Reasonableness of the covenant in the interests of the parties</b> .....	268
1 – <i>Definition of the test of reasonableness</i> .....	268
2 – <i>Distinction between employee covenants and covenants ancillary to the transfer of a business</i> .....	269
3 – <i>Factors taken into consideration to determine the reasonableness</i> .....	272
4 – <i>Point of time of reasonableness</i> .....	283
3 – <b>Absence of injury to the interests of the public</b> .	284
<b>B. Proof</b> .....	286
1 – <b>Onus of proof</b> .....	286
2 – <b>Admissibility of evidence</b> .....	287
<b>Part II – Severance of covenants not to compete</b> .....	288

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<b>Part III – Interpretation of covenants not to compete</b> .....	293
<b>A. Distance or area</b> .....	293
<b>B. « Carry on », « Engaged in », « Interested in »,         « Enter into competition »</b> .....	294
<b>C. At any time</b> .....	296
<b>Part IV – Enforcement of covenants not to compete</b> .....	296
<b>A. Assignability of a covenant</b> .....	296
<b>B. Effect of a wrongful dismissal</b> .....	297
<b>C. Recourses against third parties</b> .....	297
<b>D. Remedies for breach of covenants</b> .....	298
<b>E. Enforcement of covenants included in collective         agreements</b> .....	301
<b>F. Conflict of laws problems</b> .....	302
<b>Conclusion</b> .....	303

### **Introduction**

Covenants not to compete, which are also commonly designated by the expression “covenants in restraint of trade” or “restrictive covenants”, are frequently resorted to by employers, buyers of businesses or tenants of premises located in vast buildings or shopping centres.

For an employer, the covenant not to compete is the only effective method of protecting himself against potential competition of an employee after the termination of the contract of employment. In the absence of such a covenant, it is well established that an employee may compete in any way with his former master at the end of the contract of service, with the only restriction that he may not misuse or divulge

trade secrets or confidential information acquired during his period of service.<sup>1</sup>

A covenant not to compete is likewise necessary to secure the purchaser of a business from the competitive activities of his vendor. If there is no restriction in the contract of sale, the seller of a business may carry on a competing business next door to his former premises; he is only under an implied obligation not to solicit his former customers<sup>2</sup> which is far from affording an adequate protection for the purchaser.

The use of restrictive covenants is also of great importance for a tenant who rents store space in a big building or a vast shopping centre. If there is no special clause in the contract of lease, the landlord may lease any remaining part of his premises to a competitor of his tenant even if he thereby causes harmful effects to the latter's business.<sup>3</sup>

In dealing with these covenants,<sup>4</sup> the courts have continuously showed great concern for the protection of human liberty and for the

<sup>1</sup> *Re Irish*, (1888) 40 Ch. D. 49; D. K. DIX, *The Law Relating to Competitive Trading*, London, Sweet & Maxwell, 1938, pp. 153-154; F. R. BATT, *The Law of Master and Servant*, 4<sup>th</sup> ed., London, Sir Isaac Pitman and Sons Ltd., 1950, pp. 179-180. For a study of trade secrets in relation to the contract of service, see: H. G. FOX, *The Law of Master and Servant in Relation to Industrial and Intellectual Property*, Toronto, University of Toronto Press, 1950, pp. 108 *et seq.*; H. G. FOX, *Canadian Law of Trade Marks and Unfair Competition*, 2<sup>nd</sup> ed., Toronto, The Carswell Company Ltd., 1956, vol. 2, pp. 942 *et seq.*; P. M. NORTH, "Disclosure of Confidential Information", (1965) *The Journal of Bus. Law* 307, (1966) *The Journal of Bus. Law* 31; E. SHATZEL, "The Trade Secret Dilemma", (1965-66) 38 *U. of Col. L. Rev.* 311; *International Tools Ltd. v. Kollar*, [1968] O.R. 669, 67 D.L.R. (2<sup>d</sup>) 386 (O.C.A.). In the absence of a covenant, an ex-servant may solicit his former master's customers in so far as he does not use a secret list prepared by his master or information which he only acquired by reason of the confidential position which he occupied in the employer's business: *Ice Delivery Co., Ltd. v. Peers & Campbell*, [1926] 1 D.L.R. 1176, [1926] 1 W.W.R. 595, (1925-26) 36 B.C.R. 445 (B.C.C.A.); *Tasco Telephone Answering Exchange Ltd. v. Ellerbeck*, (1966) 57 D.L.R. (2<sup>d</sup>) 500, (1966) 55 W.W.R. 656, (1967) 48 C.P.R. 160 (B.C.S.C.).

<sup>2</sup> *Trego v. Hunt*, [1896] A.C. 7; *Read and Read v. Wright*, (1963-64) 45 W.W.R. 108 (B.C.S.C.); F. A. GARE, *The Law Relating to Covenants in Restraint of Trade*, London, The Solicitors' Law Stationery Society Limited, 1935, p. 87; WILLISTON, *Contracts*, rev. ed., 1937, para. 1640.

<sup>3</sup> *Clark's - Gamble of Canada Ltd. v. Grant Park Plaza Ltd.*, [1967] S.C.R. 614. For a general study of shopping centre leases, see: D. CARR, "Shopping centre leases", in: *The Lease in Modern Business, Special Lectures of the Law Society of Upper Canada*, 1965, at p. 237.

<sup>4</sup> These restrictive covenants form part of the traditional common law "restraints of trade" which may be classified into two groups: (1) restraints "ancillary" to underlying contracts, like contracts of employment, sale, partnership or lease; (2) restraints not "ancillary" to underlying contracts, but undertaken to divide market areas, limit production, fix prices or buy out potential competitors. "Non-ancillary" agreements were not regarded as subject to the traditional "restraint of trade" doctrine until the nineteenth century and they are now controlled by statute in Canada: *The Combines Investigation Act*, R.S.C. 1952, c. 314.

preservation of freedom of trade. In the early common law, they even took the view that such covenants were bad *in toto* and completely void because they departed from the principle of freedom of trade and labour which was considered as being of public policy. This rigid attitude was however gradually modified through the centuries with the evolution of philosophical ideas and the changing economic and social conditions. From the beginning of the eighteenth century, indeed, the courts sought to conciliate the principle of freedom of trade and labour with that of freedom of contract<sup>5</sup> and admitted that covenants not to compete were not inevitably void, but could be valid under specific conditions.

It is our purpose, in this article, to examine the rules worked out by jurisprudence in the matter of validity and enforcement of covenants not to compete. The doctrinal developments in this area of the law have been quite considerable in England from the beginning of the century until late in the nineteen thirties,<sup>6</sup> but in Canada, except for the Quebec civil law,<sup>6a</sup> there has been nothing written on the subject.

In the first part of this essay, after a brief historical survey of the law, we will attempt to set down the requirements for the validity of covenants not to compete in the light of the recent developments in jurisprudence. After that, we will see how the courts construe and interpret restrictive covenants. Finally, we will consider problems relating to the enforcement of these covenants.

<sup>5</sup> This preoccupation of the courts was well expressed by Lord Shaw of Duffermline in *Herbert Morris, Limited v. Saxelby*, [1916] A.C. 688, at p. 716: "It is because the law is the protector of freedom both of contract and of trade that it has to adjust the bounds of each [...] In these cases, as I have pointed out, there are two freedoms to be considered — one the freedom of trade and the other the freedom of contract: and to that I will now again venture to add that it is a mistake to think that public interest is only concerned with one; it is concerned with both".

<sup>6</sup> Nils Henry MOLLER, *Voluntary Covenants in Restraint of Trade. The Legal Aspect*, London, Stevens & Sons Ltd., 1925; William A. SANDESON, *Restraint of Trade in English Law*, London, Sweet & Maxwell Ltd., 1926; R. Y. HEDGES, *The Law Relating to Restraint of Trade*, London, Sir Isaac Pitman and Sons, Ltd., 1932; F. A. GARE, *The Law Relating to Covenants in Restraint of Trade*, London, The Solicitors' Law Stationery Society Ltd., 1935; D. Knight DIX, *The Law Relating to Competitive Trading*, London, Sweet & Maxwell Ltd., 1938; C. J. W. FARWELL, "Covenants in Restraint of Trade as Between Employer and Employee", (1928) 44 *L.Q.R.* 66.

<sup>6a</sup> Antonio PERRAULT, "Liberté du commerce et du travail, art. 13, 989, 990, 1667 C.C.", (1943) 3 *R. du B.* 279; Claude Armand SHEPPARD, "The enforcement of restrictive covenants in Quebec law", (1963) 23 *R. du B.* 311; Jean-Guy CARDINAL, "Clause restrictive quant à l'exercice d'une profession", (1958) 61 *R. du N.* 330; André COSSETTE, "Clauses restrictives et prohibitives dans un contrat de louage de services", (1967) 69 *R. du N.* 390; Peter M. BLAIKIE, "Restrictive covenants: conflicting views in the Court of Appeal", (1968) 14 *McGill L. J.* 120.

## Part I

## Validity of covenants not to compete

Chapter I – Historical survey of the law <sup>7</sup>

The early cases all involved post-employment covenants undertaken by apprentices or journeymen in favour of masters who desired to prolong the traditional period of subservience.<sup>8</sup> In all these cases, the covenants were considered as absolutely void without regard to their geographical scope or duration, and, in the two first cases,<sup>9</sup> the judges did not give any reason for so holding. It is only in *Colgate v. Bachelor*<sup>10</sup> that the Court of the Queen's Bench enunciated a "policy" reason for invalidating the restraint. The court reasoned that :

"this condition is against law, to prohibit or restrain any to use a lawful trade at any time, or at any place ; for as well as he may restrain him for one time or one place, he may restrain him for longer times and longer places, which is against the benefit of the commonwealth ; for being freemen, it is free for them to exercise their trade in any place [...] for he ought not be abridged of his trade and living".<sup>11</sup>

In the seventeenth century, the courts began to adopt a more liberal attitude towards restrictive covenants and a new doctrine emerged. At first applied in cases of restrictive covenants included in contracts of sale, this doctrine was thereafter extended to post-employment restraints.

<sup>7</sup> For a detailed study of the history of the common law doctrine of restraint of trade, see : W. A. SANDERSON, *op. cit. supra*, footnote 6 ; N. H. MOLLEK, *op. cit. supra*, footnote 6 ; A. A. AL-SANHOURY, *Les restrictions contractuelles à la liberté individuelle de travail dans la jurisprudence anglaise*, Paris, Giard, 1925 (Thèse-Lyon) ; H. M. BLAKE, "Employee agreements not to compete", (1959-60) 73 *Harv. L. Rev.* 625, at pp. 629 *et seq.* ; WILBERFORCE, CAMPBELL and ELLES, *The Law of Restrictive Trade Practices and Monopolies*, 2<sup>nd</sup> ed., London, Sweet and Maxwell Ltd., 1966, pp. 36 *et seq.*

<sup>8</sup> *Dyer's case*, (1414) Y.B. Mich. 2 Hen. 5, pl. 26 ; *Anonymous*, (1578) Moore K.B. 115, 72 Eng. Rep. 477 (Q.B.) ; *Colgate v. Bachelor*, (1602) Cro. Eliz. 872, 78 Eng. Rep. 1097 (Q.B.). In the *Dyer's case*, a writ of debt was brought upon an obligation undertaken by John Dyer, an apprentice, in which he agreed to refrain from practising his craft in the plaintiff's town for six months. In the *Anonymous* case, an apprentice had bound himself not to exercise his craft for four years in Nottingham. In *Colgate v. Bachelor*, the defendant's son obligated himself not to use the trade of an haberdasher within thre country of Kent, cities of Canterbury, or Rochester before a certain date.

<sup>9</sup> *Dyer's case*, *supra*, footnote 8 ; *Anonymous case*, *supra*, footnote 8.

<sup>10</sup> *Supra*, footnote 8.

<sup>11</sup> *Ibid.*, at p. 1097 (Eng. Rep.).

The case of *Rogers v. Parrey*<sup>12</sup> is the first illustration of the new approach. There the defendant, for adequate consideration, had promised that he would not, for twenty-one years in London, exercise the trade of a joiner in a shop, part of a house demised to him. Coke C. J. concluded that a man could not bind himself to the effect that he would not use his trade generally, but agreed that "for a time certain and in place certain, a man may well be bound and restrained from using his trade" and that the plaintiff was entitled in this case to sustain an action for breach of promise. In *Broad v. Jollyfe*,<sup>13</sup> a trader promised not to keep a shop in a particular place in consideration that the plaintiff would purchase the trader's old stock. The court was of the opinion that the plaintiff could sustain his action because :

"upon a valuable consideration one may restrain himself that he shall not use his trade in such a particular place ; for he who gives that consideration expects the benefit of his customers ; and it is usual here in London for one to let his shop and wares to his servant when he is out of his apprenticeship ; as also to covenant that he shall not use his trade in such a shop or in such a street : so for a valuable consideration, and voluntarily, one may agree that he will not use his trade ; for *volenti non fit injuria*".<sup>14</sup>

These cases paved the way for the case of *Mitchel v. Reynolds*<sup>15</sup> in 1711 which influenced the decisions of the courts for nearly two centuries on the question of the validity of covenants in restraint of trade. In that case, the defendant, in assigning to the plaintiff the lease of a bake shop, gave a bond that he would not practice the trade of baker within the parish for the term of the lease which was of five years. In a suit based on the bond, the defendant pleaded that his undertaking was illegal as a restraint of trade.

Lord Macclesfield stated that there was a presumption that all covenants in restraint of trade were invalid because of the mischief which may arise from them "1<sup>st</sup>, to the party, by the loss of his livelihood, and the subsistence of his family ; 2<sup>dly</sup> to the public, by depriving it of an useful member".<sup>16</sup> But he added that this presumption may be rebutted in particular cases. He then drew a distinction between "general" and "partial" restraints of trade. A "general" restraint, he said, is a restriction not to exercise a trade throughout the kingdom and

<sup>12</sup> (1613) 2 Bulst. 136, 80 Eng. Rep. 1012 (K.B.).

<sup>13</sup> (1620) Cro. Jac. 596, 79 Eng. Rep. 509 (K.B.) ; to the same effect : *Prugnell v. Gosse*, (1648) Aleyn 67, 82 Eng. Rep. 919 (K.B.).

<sup>14</sup> *Ibidem*.

<sup>15</sup> (1711) 1 P. Wms. 181, 24 Eng. Rep. 347 (Q.B.) ; also reported in *Smith's Leading Cases*, 9<sup>th</sup> american ed., 1888, vol. 1, at p. 694.

<sup>16</sup> *Ibid.*, at p. 190, 350.

must be void because it is of no benefit to either party and only oppressive "for what does it signify to a tradesman in London what another does at Newcastle?"<sup>17</sup> A "partial" restraint, such as that before the court, is limited to a particular place and can be upheld if there is "good and adequate consideration" which shows it was reasonable for the parties to enter into the contract and appears to make the contract a proper and useful one.

During nearly two centuries, *Mitchel v. Reynolds* remained the fundamental authority in the matter of restrictive covenants. It is true that throughout the nineteenth century Lord Macclesfield's opinion that general restraints were absolutely void began to be questioned<sup>18</sup> and was even clearly rejected in some cases.<sup>19</sup> But it was not until the House of Lords decision in *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co. Ltd.*<sup>20</sup> that the precedent of *Mitchel v. Reynolds* holding all nationwide restraints as inevitably void was definitely rejected and abandoned by the courts. The *Nordenfelt* case belongs as much to the next chapter as to the present historical survey of the law because, if it broke with the past, it also adapted, as it will be seen, the law in respect of restrictive covenants to modern conditions of trade. There, *Nordenfelt*, a manufacturer of guns and ammunitions, sold his business which extended to all parts of the world, and entered into a world-wide covenant not to compete for twenty-five years.

This covenant, being unlimited as to space, was clearly in "general" restraint of trade, in the sense attributed to that expression in *Mitchel v. Reynolds*. In the course of their judgments, the Lords admitted that a rule had existed which distinguished between "general" and "partial" restraints of trade and treated the former as inevitably void. But they said that the conditions under which commerce was conducted had considerably changed in recent years and that, with the development of the means of transport and communication, the dealings of an individual had ceased to be confined to the locality in which he lived, so that if the rule laid down by Lord Macclesfield had been adapted to the conditions existing at that time, it was no longer applicable to the conditions existing at the end of the nineteenth century. Lord Herschell, for instance, stated that

<sup>17</sup> *Ibid.*, at p. 191, 350.

<sup>18</sup> *Horner v. Graves*, (1831) 7 Bing 735, 131 Eng. Rep. 284; *Hitchcock v. Coker*, (1837) 6 Ad & E. 438, 112 Eng. Rep. 167.

<sup>19</sup> *Whittaker v. Howe*, (1841) 3 Beav. 383, 49 Eng. Rep. 150; *Leather Cloth Co. v. Lorsche*, (1869) L. R. 9 Eq. 345; *Rousillon v. Rousillon*, (1880) 14 Ch. D. 351. One Canadian case followed this trend: *Wicher v. Darling*, (1885) 9 O.R. 311.

<sup>20</sup> [1894] A.C. 535.



“regard must be had to the changed conditions of commerce and of the means of communication which have been developed in recent years”

and that if conditions prevailing in 1894 had existed in Lord Macclesfield’s time, the latter

“would not have laid down a hard-and-fast distinction between general and particular restraints, for the reasons by which he justified that distinction would have been unfounded in point of fact”.<sup>21</sup>

The Lords’ consensus was to the effect that the distinction between “general” and “partial” restraints of trade ought to be abandoned and that the test of reasonableness, applied by Lord Macclesfield to “partial” restraints only, should be extended to judge the validity of “general” restraints. The covenant agreed upon by Nordenfelt was therefore upheld because, in the Lords’ opinion, it was reasonable in that it did not exceed what was necessary for the protection of the covenantee and was not contrary to the public interest.

With the overthrow of the doctrine of *Mitchel v. Reynolds*, the history of the subject may be regarded as closed. This does not mean that the law came to a standstill in 1894 ; there have since been many developments, but they form part of the law as it is today.<sup>22</sup>

## Chapter II – The modern law

The foundation of the modern common law on the validity of covenants not to compete, in Canada as well as in England, is Lord Macnaghten’s statement in the *Nordenfelt* case. Lord Macnaghten then argued that all covenants in restraint of trade were prima facie void, but could be justified if shown to be reasonable in the interests of the parties and of the public. The relevant passage of his judgment is as follows :

“The true view at the present time, I think, is this : the public has an interest in every person’s carrying on his trade freely : so has the individual. All interference with individual liberty of action in trading, and all restraints of trade, of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions : restraints of trade

<sup>21</sup> *Ibid.*, at p. 547.

<sup>22</sup> In Canada, during the period preceding the *Nordenfelt* case, there seems to be only two reported cases on covenants not to compete ancillary to a contract of employment or sale of a business : *Mossop v. Mason*, (1871) 13 Gr. 453 (O.C.A.), in which *Mitchel v. Reynolds* was applied, and *Wicher v. Darling*, *supra*, footnote 19, which departed from the rule that “general” restraints were necessarily void. The development of the American law, during the nineteenth century, paralleled the English pattern : H. M. BLAKE, *loc. cit. supra*, footnote 7, at p. 643 ; Gary L. BRYENTON, “Validity and Enforceability of Restrictive Covenants Not To Compete”, (1964) *Western Res. L. Rev.* 160, at p. 165.

and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is sufficient justification, and indeed, it is the only justification, if the restriction is reasonable — reasonable, that is, in the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public. That, I think, is the fair result of all the authorities".<sup>23</sup>

Lord Macnaghten's proposition was authoritatively approved and refined in two House of Lords decisions involving covenants not to compete in contracts of employment, the *Mason* case in 1913<sup>24</sup> and the *Herbert Morris* case in 1916.<sup>25</sup> These last two cases, together with the *Nordenfelt* case, form the core of the English and Canadian<sup>26</sup> law on the validity of covenants not to compete. They dealt with both the substantive and procedural aspects of the law on this subject and the general rules which are still applied by the courts today originate from these three cases.

In the following sections we will consider first what the substantive requirements are for the validity of covenants not to compete in the actual state of the Canadian law and, secondly, we will examine the problems relating to the proof of these requirements.

### A. Substantive requirements

Whatever may be the type of contract in which a covenant not to compete is included, it flows from the dictum of Lord Macnaghten as completed by the following jurisprudence that three specific conditions are required for its validity : firstly, the covenantee must have a right or an interest to protect ; secondly, the covenant must be reasonable in the interests of the parties ; and thirdly, it must not be injurious to the interests of the public. Let us examine separately each of these conditions.

#### 1. *Existence of a covenantee's interest to protect*

It is a fundamental requirement that there must always be some interest which needs protection before a covenant not to compete can be

<sup>23</sup> *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.*, *supra*, footnote 20, at p. 565.

<sup>24</sup> *Mason v. Provident Clothing and Supply Co.*, [1913] A.C. 724.

<sup>25</sup> *Supra*, footnote 5.

<sup>26</sup> "The Canadian cases [...] have followed the principles laid down in the English decisions. Most of these cases have turned on the application of the settled principles to varying circumstances". Richard Gosse, *The Law on Competition in Canada*, Toronto, The Carswell Co. Ltd., 1962, p. 47.

declared valid by the courts. The law does not tolerate a covenant in gross.<sup>27</sup> If a covenantee has no right or interest to protect, a covenant is wholly bad, as being against public policy. In *Townsend v. Jarman*,<sup>28</sup> Farwell J. said :

“Now, if one-man, apart from any business takes a covenant in gross from another man, that he will not trade at all, that is simply oppressive. He does not require it to protect his own interest, because he has no interest to protect”.

The same opinion was clearly expressed in *Herbert Morris Ltd. v. Saxelby*,<sup>29</sup> a master and servant case, particularly by Lord Atkinson who stated that “no person has an abstract right to be protected against competition per se in his trade or business [. . .]”<sup>30</sup> and that “in all cases such as this, one has to ask oneself what are the interests of the employer that are to be protected, and against what is he entitled to have them protected.”<sup>31</sup> These propositions were entirely approved by the Supreme Court of Canada in *Maguire v. Northland Drug Co. Ltd.*<sup>32</sup> In *Vancouver Malt and Sake Brewing Company Ltd. v. Vancouver Breweries Ltd.*,<sup>33</sup> a case of buyer and seller, the appellants held a brewer’s licence in respect of their premises in Vancouver under which they were at liberty to brew beer. In fact, however, they brewed only sake, a Japanese liquor made from rice. The respondents held a similar licence and did brew beer only. The appellants purported to sell and assign to the respondents for \$15,000 the goodwill of their brewer’s licence, except in so far as it related to the manufacture, distribution and sale of sake, and agreed not to engage in the trade or business of manufacturing or selling beer for fifteen years.

The Privy Council held that since the appellants were not in fact brewers of beer, the contract transferred to the respondents no proprietary interest in respect of which a restrictive covenant was justifiable ; it therefore considered the covenant as being in reality a bare covenant against competition and it declared it void.

The interests which may justify a covenant not to compete vary with the type of contract in which the covenant is included. The pur-

<sup>27</sup> CHESHIRE and FIFOOT, *The Law of Contract*, 5<sup>th</sup> ed., London, Butterworth & Co. (Publishers) Ltd., 1960, p. 314 ; BATT, *op. cit. supra.*, footnote 1, p. 99.

<sup>28</sup> (1900) 2 Ch. 698, at p. 703.

<sup>29</sup> *Supra*, footnote 5.

<sup>30</sup> *Ibid.*, at p. 700.

<sup>31</sup> *Ibid.*, at p. 701.

<sup>32</sup> [1935] S.C.R. 412.

<sup>33</sup> [1934] A.C. 181, [1934] 2 D.L.R. 310, [1934] 1 W.W.R. 471, [1934] All E.R. 38.

chaser of a business, for instance, is entitled to impose a covenant upon the seller in order to protect the business purchased ; he could not, however, stipulate a covenant to protect a business he is already carrying on.<sup>34</sup> Similarly, a tenant may bind his landlord by a covenant not to compete in order to protect the business he is carrying on within the rented premises ; but he could not, by a restrictive covenant, attempt to protect a business he is carrying on at another place.

As to an employer, he may enforce a covenant not to compete against an employee only if it is designed to protect what has been called his "proprietary" rights, that is to say his trade secrets or customer relationships. No covenant will be upheld against an employee who does not present any risk either to the employer's trade connection or with respect to confidential business information. An employer cannot use a restrictive covenant merely to prevent his employee from using for himself or in the establishment of a trade rival the general knowledge, skill or proficiency which the employee has acquired and developed in the course of his employment. These principles have been clearly formulated for the first time in the leading case of *Herbert Morris Ltd. v. Saxelby*.<sup>35</sup> In this case, the defendant, on leaving school, had entered the plaintiff company's employment as junior draughtsman. The company was the leading manufacturer of hoisting machinery in the United Kingdom. After several years service, the defendant was engaged as engineer and became head of one of the company's departments. The contract of employment contained a covenant by the defendant with the company that he would not, during a period of seven years from his ceasing to be employed by the company, either in Great Britain or Ireland, engage in the sale or manufacture of pulley blocks, hand overhead runways, electric overhead runways, or hand overhead travelling cranes. The covenant was held void because of the absence of any proprietary interest entitled to protection on the part of the company. Lord Parker of Waddington made it clear that only trade secrets and customer relationships could support a covenant not to compete. He said :

"In fact the reason, and the only reason, for upholding such a restraint on the part of an employee is that the employer has some proprietary right, whether in the nature of trade connection or in the nature of trade secrets, for the protection of which such a restraint is — having regard to the duties of the employee —

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<sup>34</sup> W. R. ANSON, *Principles of the English Law of Contract*, 22<sup>nd</sup> ed. by A. B. GUEST, Oxford, The Clarendon Press, 1964, p. 327 ; *British Reinforced Concrete Engineering Co. Ltd. v. Schelff*, [1921] 2 Ch. 563.

<sup>35</sup> *Supra*, footnote 5.

reasonably necessary. Such a restraint has, so far as I know, never been upheld, if directed only to the prevention of competition or against the use of the personal skill and sknowledge acquired by the employee in his employer's business".<sup>36</sup>

Lord Atkinson expressed the same opinion. After having said that the danger against which the company desired to be protected was only that the employee might put to use in the establishment of trade rivals the superior skill and knowledge he had acquired in his employment, he quoted with approval Farwell J. who had stated in *Sir W. C. Leng & Co. v. Andrews*<sup>37</sup> that an employer cannot prevent his employee from using the skill and knowledge in his trade or profession which he has learnt in the course of his employment by means of directions or instructions from the employer.

The principles enunciated in the *Herbert Morris* case have been approved by the Supreme Court of Canada in *Maguire v. Northland Drug Co. Ltd.*<sup>38</sup> and are stil applied by the Canadian courts. In *Fisher v. Rosenberg*,<sup>39</sup> the plaintiffs were partners in a business of promoting attendance at baseball, basketball and hockey games in Canada and in the United States. They had hired the defendant as a promotional unit manager under an agreement which contained, in addition to a covenant prohibiting him from disclosing the employer's list of customers, the following clause :

"The employee recognizes the valuable, special [...] training which he will receive from the employer [...]. The employee further acknowledges the employer has developed valuable, special [...] methods of transacting business, all to be taught to the employee. It is therefore [...] agreed that for a period of 2 years after the termination of this agreement, the employee will not [...] engage [...] in any business similar to the type of business conducted by the employer".

Bastin J. held that the "valuable, special and unique training" in the "valuable, special and unique methods of transacting business" did not constitute trade secrets and merely imparted to the employee additional skill which he should reasonably be entitled to use in earning his livelihood and that the covenant restraining him from engaging in a competitive business was therefore contrary to public policy. In *Furlong v. Bruns & Co. Ltd.*,<sup>40</sup> the court also took the view that as there was

<sup>36</sup> *Ibid.*, at p. 710.

<sup>37</sup> [1909] 1 Ch. 763, at p. 773.

<sup>38</sup> *Supra*, footnote 32.

<sup>39</sup> (1960) 67 Man. R. 336 (Man. Q.B.).

<sup>40</sup> (1964) D.L.R. (2<sup>a</sup>) 689, [1964] 2 O.R. 3 (O.H.C.).

no evidence that the employee possessed trade secrets or was in contact with customers a covenant not to compete could not be upheld.<sup>41</sup>

It is therefore clear from the jurisprudence that an employee may be restrained from entering into competition with his former employer only if he has been entrusted with a trade secret during his employment or presents a risk to the employer's customer relationships. In some cases, it may happen that an employee acquired his proficiency and skill through an expensive and costly training which constitutes a certain investment made by the employer in the employee. It might seem equitable, then, for the employer to be allowed to make it more difficult for the employee to leave by preventing him from going into a competitive employment, even if there is no trade secret or no risk of unfair invasion of the employer's trade connection by the employee. It is doubtful if such an argument would be sufficiently persuasive to lead the courts to depart from the actual rule that trade secrets and business connection are the only matters in respect of which an employer has interests important enough to justify an employee covenant not to compete.

It is difficult to determine exactly what kind of information imparted to an employee may constitute a trade secret within the meaning in which this concept is used by the courts. It seems accepted that a process or mode of manufacture which is unique or different from those used generally in the industry may be considered as a trade secret if the employer communicates it to an employee on a confidential basis and if all reasonable precautions are taken to keep the information secret.<sup>42</sup> May the business data of a company, its retailing methods, its sources of supply, its internal structure and the like, which knowledge has been acquired by an employee, warrant a covenant not to compete? In the *Herbert Morris* case,<sup>43</sup> it was decided that the general scheme of organisation and the methods of transacting business cannot be classified as trade secrets. The same reasoning has prompted Canadian courts to invalidate covenants not to compete undertaken by managerial employees on the ground that there was not sufficient interest to support them, even if these employees had acquired an intimate knowledge of the internal structure and the working of the business.<sup>44</sup> Even a

<sup>41</sup> See also : *City Dray Co. Ltd. v. Scott*, [1950] 4 D.L.R. 657, [1950] 2 W.W.R. 913 (Man. K.B.); *Colonial Broadcasting System Ltd. v. Russell*, (1965) 48 D.L.R. (2<sup>d</sup>) 242 (Nfld S.C.); *American Building Maintenance Co. Ltd. v. Shandley*, (1966) 58 D.L.R. (2<sup>d</sup>) 525, (1966) 57 W.W.R. 133 (B.C.C.A.).

<sup>42</sup> *International Tools Ltd. v. Kollar*, (1968) 67 D.L.R. (2<sup>d</sup>) 386 (O.C.A.).

<sup>43</sup> *Supra*, footnote 5, at pp. 703-705, 711-712.

<sup>44</sup> *Furlong v. Burns & Co. Ltd.*, *supra*, footnote 40 ; *Fisher v. Rosenberg*, *supra*, footnote 39.

stipulation in a covenant that the employee will regard as trade secrets special methods of business taught to him by the employer is of itself insufficient to justify a covenant not to compete. In *American Building Maintenance Co. Ltd. v. Shandley*,<sup>45</sup> the defendant was branch manager of the plaintiff engaged in the business of contracting for janitorial services in Vancouver. A clause in the contract of employment provided that the actual costs of doing the jobs of customers, the methods used in determining the prices charged, and materials and equipment used by the plaintiff in performing its services, constituted trade secrets. The defendant had undertaken a covenant not to engage in a similar business for 3 years in certain areas. It was held that plaintiff's method of carrying on its business could not, having in mind the nature of the business, be a trade secret simply by naming it to be so, and that, the employer having no proprietary rights to protect, the restrictive covenant was invalid.

An employer is also entitled to retain his customers and to prevent them from being diverted from him by a former employee. He has the right to protect himself against the risk of loss of his clientele to an ex-servant who had opportunities to become acquainted with it. It is difficult, however, to determine in each case if the risk is sufficiently great to warrant a covenant not to compete. In *Gilford Motor Co. v. Horne*,<sup>46</sup> Romer L. J. propounded the following test :

"It is in my opinion established that when an employee is being offered employment which will probably result in his coming into direct contact with his employer's customers, or which will enable him to obtain knowledge of the names of his employer's customers, then the covenant against solicitation is reasonably necessary for the protection of the employer".

In our opinion, this statement is too sweeping. The mere fact of frequent customer contacts is not of itself sufficient to provide a basis for a restrictive covenant. Office workers or clerks in retail stores, for instance, may be in personal contact with customers, but the circumstances of the contact do not generally make them a serious source of potential danger to the employer.

Whether an employer needs the protection of a restrictive covenant depends fundamentally upon the nature of the functions performed by the employee. When an employee must work closely with the client over a long period of time, or when by the nature of the employment customers learn to rely on the skill, judgment or cleverness of the employee, or in situations in which the employee constitutes the only link

<sup>45</sup> *Supra*, footnote 41.

<sup>46</sup> [1933] Ch. 935, at p. 966, [1933] All E.R. 109.

between the master and the customers, with the result that the employee has gained influence over the customers and that the employer is likely to lose customers if the employee decides to leave to set up his own business or to take a position with a competitive firm, a covenant not to compete is then justifiable.<sup>47</sup>

Thus, some degree of restraint is supportable in most cases where there are repeated visits to a customer's home, as in the case of laundry delivery men or milk or bread roundsmen.<sup>48</sup> A covenant undertaken by sales representatives<sup>49</sup> or by sales managers or branch managers who are in contact with customers are also apt to be upheld.<sup>50</sup> Restraints imposed upon professional employees, as associates or assistants of physicians or accountants have also been held to be justifiable when there was a customer relationship.<sup>51</sup> The view taken by the Supreme Court of Canada in *Maguire v. Northland Drug Co.*<sup>52</sup> is in opposition to this line of thought and the authority of this case called "the leading Canadian case on termination of employment with a restrictive covenant"<sup>53</sup> is questionable. In this case, the appellant, a pharmaceutical druggist, employed by the respondent company in its retail drug store in Flin Flon, had signed a covenant in the form of a bond under seal. This covenant prohibited him, if he should leave or be dismissed from the respondent's service, from carrying on or being engaged in the busi-

<sup>47</sup> "Where the circumstances are such that the servant has, by virtue of his engagement, been put in the position [...] of acquiring a special or intimate knowledge of the affairs of the customers, clients or patients of his master's business or of means of influence over them, there exists a subject-matter of contract, a proprietary interest or goodwill in the matter that is entitled to protection [...]". Per Evershed J. in *Routh v. Jones*, [1947] 1 All E.R. 179 at p. 181, affirmed by [1947] 1 All E.R. 758 (C.A.).

<sup>48</sup> Among the "route" cases, see: *Skeans v. Keegan*, (1916) 10 O.W.N. 225 (O.H.C.); *New Method Cleaners & Launderers Ltd. v. Hartley*, [1939] 1 D.L.R. 711, [1939] 1 W.W.R. 142, (1939) 46 Man. R. 414 (Man. C.A.); *Peerless Laundry & Cleaners Ltd. v. Neal*, [1953] 2 D.L.R. 494, (1953) 8 W.W.R. 309 (Man. C.A.); *Nelson Laundries Ltd. v. Manning*, (1965) 51 D.L.R. (2<sup>d</sup>) 537, (1965) 51 W.W.R. 493 (B.C.S.C.).

<sup>49</sup> *Gestetner (Canada) Ltd. v. Henderson*, [1948] 2 W.W.R. 84, [1948] 3 D.L.R. 64 (Alb. C.A.); *P.C.O. Services Ltd. v. Rumleski*, (1963) 38 D.L.R. (2<sup>d</sup>) 390, [1963] 2 O.R. 62 (O.H.C.); *E. P. Chester Ltd. v. Mastorkis*, (1968) 70 D.L.R. (2<sup>d</sup>) 133 (N.S.C.A.).

<sup>50</sup> *Lock v. Nelson & Harvey Ltd.*, (1960) 22 D.L.R. (2<sup>d</sup>) 298, 33 C.P.R. 138 (B.C.S.C.).

<sup>51</sup> Physicians: *Hall v. More*, [1928] 1 D.L.R. 1028, [1928] 1 W.W.R. 400, (1928) 39 B.C.R. 346 (B.C.C.A.); *Mills v. Gill* [1952] 3 D.L.R. 27, (1952) 16 C.P.R. 46, [1952] O.R. 257 (O.H.C.). Accountants: *Campbell, Imrie and Shankland v. Park*, [1954] 2 D.L.R. 170, (1953) 21 C.P.R. 1 (B.C.S.C.). There are many English cases involving solicitors' clerks in which restraints have generally been upheld; but no such cases seem to have been taken to the courts in Canada.

<sup>52</sup> *Supra*, footnote 32.

<sup>53</sup> A. C. CRYSLER, *Restraint of Trade and Labour*, Toronto, Butterworths, 1967, p. 125.



ness of retail druggist for five years within twenty-five miles of Flin Flon except with the consent in writing of the respondent. About four years later, Maguire was dismissed and immediately began to work for a company which had opened another drug store in Flin Flon. The Manitoba Court of Appeal<sup>54</sup> found that Maguire had acquired intimate and personal knowledge of the customers by his relations with them and had become after four years of services, identified with the business, so that he could not fail to entice away the respondent's customers on becoming manager of another drug store next door. The Court upheld the covenant and granted both an injunction and damages. The Supreme Court reversed this decision. Dysart J.<sup>55</sup> stated that since no trade secrets were involved and no private knowledge concerning customers, their names and addresses seemed to have been revealed, the covenant was designed to prevent competition *per se* and was illegal. He added that if customers had transferred their patronage from the old to the new store, they were free to do so at will, and the respondent had no grounds of complaint so long as the change was not brought about by the solicitation and canvassing of the appellant.

The fact that the appellant, because of the nature of the professional functions he performed and because of the intimate relations he had with the respondent's customers, was likely, upon his leaving, to draw to a nearby store the respondent's customers did not therefore appear to Dysart J. to be sufficient to justify a restrictive covenant. According to his reasoning, a covenant not to compete would be justifiable only if an employee has acquired confidential information concerning his master's customers. This opinion was approved in some subsequent cases. In *T. S. Taylor Machinery Co. Ltd. v. Biggar*,<sup>55a</sup> for instance, the Manitoba Court of Appeal held that the employer had no proprietary interest respecting customers which required protection since "it was not suggested that there was any secret list of customers nor any confidential information as to any known customer".<sup>55b</sup> In the great majority of Canadian cases, however, the courts have not taken such a strict view. They have rather decided that a restrictive covenant is justified whenever there is a substantial risk that an employee, by the nature of his work, may be able to entice away his employer's customers.<sup>56</sup> Following this reasoning, a restrictive covenant might not be justifiable

<sup>54</sup> [1934] 2 W.W.R. 298. See in particular Prendergast C. J. A. at p. 300, Denistoun J. A. at p. 301, and Richards J. A. at p. 324.

<sup>55</sup> Speaking for Duff, Lamont and Cannon, J. J.

<sup>55a</sup> (1969) 2 D.L.R. (3<sup>d</sup>) 281 (Man. C.A.). See also *City Dray Co. Ltd. v. Scott*, *supra*, footnote 41.

<sup>55b</sup> *Ibid.*, at p. 289.

<sup>56</sup> See cases cited *supra*, footnote 48, 49, 50 and 51.

in cases where the business is one in which customers do not normally recur, as that of a house agent,<sup>57</sup> or in which sales are highly infrequent, as that of sale of major household appliances, because in these cases the risk of losing a former employee is minimized.<sup>58</sup>

Let us add that there should be a limitation to the general rule that a substantial risk of losing customers is itself an adequate basis to support a restrictive covenant. In the case where the employee brings with him "customers" when he enters employment, it is submitted that the employee has a "proprietary" interest in these customers whom he drew to him by his own efforts and that an employer should not be allowed to exact a covenant not to compete in order to retain these customers after the departure of the employee. In *M. & S. Drapers v. Reynolds*<sup>59</sup> a collector-salesman had entered the employment of a firm of credit drapers in bringing with him many customers and had undertaken for a period of five years following the termination of his employment not to sell or solicit orders from persons inscribed as customers on the books of the firm during the three years preceding the termination of his employment. Denning L. J. said :

"In this case I think that the employers might reasonably protect their own trade connexion, that is, the connexion which was properly their own as distinct from the connexion which the traveller brought with him. But I do not see why the employers should be able to forbid him to call on the people whom he already knew before he worked for them the people whom I will call "his customers". His knowledge of these people, and his influence with them, were due to his efforts or at any rate they were nothing to do with these employers. His goodwill with those customers belonged to him, and cannot reasonably be taken from him by a covenant of this kind".<sup>60</sup>

We think that the principles enunciated by Lord Denning ought also to be applied in the Canadian law.<sup>61</sup>

<sup>57</sup> There is no Canadian case to illustrate this affirmation ; but see an English case, *Bowler v. Lovegrove*, [1921] 1 Ch. 642, 37 T.L.R. 424. However in *Scorer v. Seymour Jones*, [1966] 1 W.L.R. 1419 (Eng. C.A.), a covenant not to compete undertaken by the employee of a firm of estate agents was held to be justifiable because many customers were recurring customers.

<sup>58</sup> In *American Building Maintenance Co. Ltd. v. Shandley*, *supra*, footnote 41, the employer was engaged in the business of contracting for janitorial services. The evidence showed that this type of business was very competitive and that the contracts changed hands very frequently so that "ownership in a customer lasts only during the ownership of a contract". Lord J. A., at p. 532 (D.L.R.) expressed his view as follows : "If that be so the appellant (the employer) has lost the "proprietary right" in the "nature of a trade connection".

<sup>59</sup> [1957] 1 W.L.R. 9 (Eng. C.A.).

<sup>60</sup> *Ibid.*, at p. 18. Morris L. J. also expressed the same opinion at p. 17.

<sup>61</sup> Dickson J., in *Northern Messenger and Transfer Ltd. v. Fabro*, (1964) 49 W.W.R. 115 at p. 121, (1964) 45 D.L.R. (2<sup>d</sup>) 73 at p. 78 (Man. Q.B.) approved Lord Denning's view in an obiter dictum.

## 2. Reasonableness of the covenant in the interests of the parties

### 1 - Definition of the test of reasonableness.

Although a covenant not to compete is directed to the protection of a proprietary interest of the covenantee and is therefore justifiable, it will yet be invalid unless it is reasonable in the interests of the parties. This general test of reasonableness, which was authoritatively laid down for the first time in the *Nordenfelt* case which definitively rejected the mechanical partial-general restraint distinction, was refined and given a more precise meaning in *Herbert Morris Ltd. v. Saxelby*.<sup>62</sup> Lord Parker of Waddington there stated that to be reasonable in the interests of the parties, a restraint must afford adequate but no more than adequate protection to the party in whose favour it is imposed.<sup>63</sup> Lord Atkinson also said that if the restraint affords to the person in whose favour it is imposed nothing more than reasonable protection against something which he is entitled to be protected against, then as between the parties concerned the restraint is to be held to be reasonable in reference to their respective interests.<sup>64</sup>

At first sight, it seems preposterous to affirm that if a covenant not to compete is tailored just to adequately protect the covenantee, it is also automatically in the interests of the covenantor. Lord Parker justified his proposition by saying that the covenantor obtained indirect advantages by subjecting himself to a covenant not to compete which was not wider than necessary to secure an adequate protection to the covenantee. He said :

"So conceived the test appears to me to be valid both as regards the covenantor and the covenantee, for though in one sense no doubt it is contrary to the interests of the covenantor to subject himself to any restraint, still it may be for his advantage to be able so to subject himself in cases where, if he could not do so, he would lose other advantages, such as the possibility of obtaining the best terms on the sale of an existing business or the possibility of obtaining employment or training under competent employers. As long as the restraint to which he subjects himself is no wider than is required for the adequate protection of the person in whose favour it is created, it is in his interest to be able to bind himself for the sake of the indirect advantages he may obtain by so doing".<sup>65</sup>

English and Canadian courts<sup>66</sup> still apply the reasonableness test as it was defined by the House of Lords in *Herbert Morris* and their

<sup>62</sup> *Supra*, footnote 5.

<sup>63</sup> *Ibid.*, at p. 707.

<sup>64</sup> *Ibid.*, at p. 700.

<sup>65</sup> *Ibid.*, at p. 707.

<sup>66</sup> See for instance : *Gordon v. Ferguson*, (1961) 46 M.P.R. 177, (1961) 30 D.L.R. (2<sup>d</sup>) 420, (1962) 38 C.P.R. 1 (N.S.C.A.), affirmed without reasons by the Supreme Court of Canada : (1962) 46 M.P.R. 344, (1962) 40 C.P.R. 43.

reasonings tend to confirm that they have tacitly accepted the equation established by Lord Parker between the interests of the covenantor and the no more than adequate protection of the covenantee. It is true that, in some cases, the courts have said that a covenant is reasonable if it is no wider than required for the protection of the covenantee while at the same time it does not impose undue hardship on the covenantor.<sup>67</sup> This proposition would lead one to think that personal circumstances of the covenantor should be taken into consideration to determine the reasonableness of a covenant not to compete. But the courts have never really paid attention to this. Once they have completed the analysis of the extent of the protectible interests, courts usually find all other considerations irrelevant in determining the reasonableness of a covenant. Personal interests or circumstances of the covenantor are bluntly slighted.

Further, since *Hitchcock v. Coker*,<sup>68</sup> the courts do not consider the adequacy of the consideration received by the covenantor. Lord Parker made it plain in the *Herbert Morris* case<sup>69</sup> that the court has not to weigh the advantages accruing to the covenantor under the contract against the disadvantages imposed upon him by the restraint.

## 2—Distinction between employee covenants and covenants ancillary to the transfer of a business.

The test of reasonableness as laid down in the *Herbert Morris* case applies to all covenants not to compete, whether they are embodied in a contract of service or contained in a sale of a business agreement. But the courts have made a much more stringent application of that test in cases of covenants ancillary to a contract of employment than in cases of covenants incidental to the transfer of a business.<sup>70</sup> They have regarded the former type of covenants much more jealously and

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<sup>67</sup> *Maguire v. Northland Drug Co.*, *supra*, footnote 32; *Campbell, Imrie and Shankland v. Park*, *supra*, footnote 51.

<sup>68</sup> *Supra*, footnote 18. In: *Mitchel v. Reynolds*, *supra*, footnote 15, and in the other early cases, the view was taken that to support a covenant not to compete there must be an adequate consideration. The covenantor ought to receive adequate reward or advantages for subjecting himself to a restrictive covenant.

<sup>69</sup> *Supra*, footnote 5, at p. 707.

<sup>70</sup> Covenants between partners are given the same treatment as covenants between buyer and seller: GARE, *op. cit. supra*, footnote 6, pp. 92-93. See also *Sotiroff v. Dimitroff*, [1933] O.W.N. 249 (O.H.C.). In: *Whitehill v. Bradford*, [1952] 1 Ch. 236, [1952] 1 All E.R. 115 (Eng. C.A.), the court equated an agreement between professional partners to the sale of a business for the purposes of the application of the test of reasonableness to a covenant not to compete. See also *Ronbar Enterprises Ltd. v. Green*, [1954] 2 All E.R. 266, 1 W.L.R. 815.

less favourably than the latter type of covenants and accordingly a restraint may be unreasonable as between employer and employee which would be reasonable as between the vendor and purchaser of a business. Decisions involving one type of covenant have therefore very little persuasive effect in dispute involving another type. Lord Macnaghten, in the *Nordenfelt* case,<sup>71</sup> was the first to clearly enunciate this distinction :

“To a certain extent, different considerations must apply in cases of apprenticeship and cases of that sort, on the one hand, and cases of the sale of a business or dissolution of partnership on the other [..]. There is obviously more freedom of contract between buyer and seller than between master and servant or between an employer and a person seeking employment”.

This proposition was accepted and developed by the House of Lords in the *Mason* case<sup>72</sup> and in the *Herbert Morris* case,<sup>73</sup> and was also adopted by the Canadian courts.<sup>74</sup> In the Canadian law as well as in the English law, a covenant not to compete may therefore be imposed more readily and widely upon the vendor of a business in the interests of the purchaser than upon an employee in the interests of the employer. Even if a covenant must always be reasonable, the extent of restraint permissible in the two types of cases is different.<sup>75</sup> This difference seems to be based on the following considerations.

Firstly, in the case of transfer of a business and its goodwill, a restrictive covenant imposed upon the seller is necessary to effectively carry out the transaction and allow the purchaser to get the full value of the thing he acquired ; if the seller is free to continue his trade with his old customers, it is obvious that he will greatly diminish the value of the thing sold. A restraint on the transferor in such a case therefore runs concurrently with the use of the property by the transferee. Unlike a restrictive covenant accompanying the sale of a business, an employee restraint is not necessary for the employer to get the full value of the thing being acquired, that is to say the employee's current services. The promise not to compete after the termination of the employment is some-

<sup>71</sup> *Supra*, footnote 20, at p. 566.

<sup>72</sup> *Supra*, footnote 24.

<sup>73</sup> *Supra*, footnote 5, at p. 701 per Lord Atkinson, at p. 708 per Lord Parker and at pp. 713-714 per Lord Shaw.

<sup>74</sup> *Allen Manufacturing Co. v. Murphy*, (1911) 23 O.L.R. 467, (1911) 18 O.W.R. 572, (1911) 2 O.W.N. 877 (O.C.A.), reversing 22 O.L.R. 539 (Div. C.); *Mizon v. Pohoretzky*, (1918) 38 D.L.R. 214, (1917) 40 O.L.R. 239 (O.C.A.); *Maguire v. Northland Drug Co. Ltd.*, *supra*, footnote 32; *Furlong v. Burns and Co. Ltd.*, *supra*, footnote 40; *T. S. Taylor Machinery Co. Ltd. v. Biggar*, *supra*, footnote 55a.

<sup>75</sup> The same distinction also exists in the American law : BLAKE, *op. cit. supra*, footnote 7, at pp. 646 *et seq.*

thing additional that the employer attempts to obtain. Lord Parker of Waddington emphasized that in the *Herbert Morris* case : <sup>76</sup>

“It was argued before your Lordships that no distinction can be drawn between the position of the purchaser of the goodwill of a business taking such a covenant from his vendor and the case of the owner of a business taking such a covenant from his servant or apprentice [...]. The distinction between the two cases is, I think, quite clear, and is recognized by Lord Macnaghten and Lord Herscheld in the *Nordenfelt* case. The goodwill of a business is immune from the danger of the owner exercising his personal knowledge and skill to its detriment, and if the purchaser is to take over such goodwill with all its advantages it must, in his hands, remain similarly immune. Without, therefore, a covenant on the part of the vendor against competition, a purchaser would not get what he is contracting to buy, nor could the vendor give what he is intending to sell. It is quite different in the case of an employer taking such a covenant from his employee or apprentice. The goodwill of his business is, under the conditions in which we live, necessarily subject to the competition of all persons (including the servant or apprentice) who choose to engage in a similar trade. The employer in such a case is not endeavouring to protect what he has, but to gain a special advantage which he could not otherwise secure”.

For this reason, the courts do look much more critically at restrictive covenants undertaken by employees than at restrictive covenants entered into by the seller of a business.

Secondly, as Lord Justice Philmore put it in *Herbert Morris Ltd. v. Saxelby*, <sup>77</sup> the vendor and the purchaser of a business are deemed to be on an equal footing but in cases of employment the parties are ordinarily in unequal bargaining positions and the employee, who is the weaker party, may find it difficult to resist the imposition of terms favourable to the employer and unfavourable to himself. Moreover, a binding covenant not to compete has a tendency to reduce an employee's bargaining power and freedom to seek better conditions during his employment, even by asking for a rise in wages, for should he be unsuccessful, his choice of fresh employment would be considerably narrowed. <sup>78</sup> For these reasons, courts have always been more reluctant to enforce a covenant between an employer and employee than a covenant between a seller and buyer and they have continuously scrutinized its terms very severely to determine its reasonableness.

Finally, another consideration may have unconsciously influenced the courts in allowing greater freedom of contract and correspondingly accepting wider restraints of trade in contracts of sale than in contracts

<sup>76</sup> *Supra*, footnote 5, at pp. 708-709.

<sup>77</sup> [1915] 2 Ch. 57, at p. 82. So the same effect : Wilson C. J. in : *Cope v. Harasimo*, (1964) 46 W.W.R. 276, at p. 288 (B.C.S.C.).

<sup>78</sup> Per Denning L. J., in : *M. & S. Drapers v. Reynolds*, *supra*, footnote 59, at p. 18.

of employment. It is the fact that if an employee cannot exercise his profession or calling, he is deprived of his only mean to earn his living while a seller of property is more likely to have other sources of income or, in any event, income from the capital arising from the sale. An employee may consequently be more badly hurt by a covenant not to compete than the seller of a business.

Even if the validity of covenants not to compete is more readily upheld in cases of sale of a business than in cases of contract of employment, it is important to remember that the same general test, that of reasonableness, applies to both classes of cases. It is the application of the test to particular cases which is made differently and which brings different results. "The same test, that of reasonableness, applies to both, [cases of employment relationship and sale of businesses] but, whereas the buyer of a business is entitled to complete, though reasonable, protection from all subsequent competition, an employer is allowed only such protection as is necessary to secure him from an exploitation by his former employee of the knowledge of his customers and his trade secrets gained as a result of the employment".<sup>79</sup>

### 3 – Factors taken into consideration to determine the reasonableness.

#### a) *covenants included in a contract of employment.*

To determine whether a covenant not to compete affords no more than adequate protection for the employer and is therefore reasonable, the courts take into consideration the duration of the restriction, its geographical extent<sup>80</sup> and the scope of the activities prohibited to the employee. It is not to say that these three elements are considered separately with respect to fixed standards for each of them ; they are interlocked and whether a restraint's duration is reasonable, for instance, may well turn on the extent of geographical area. As said Lord Birkenhead in *Fitch v. Dewes*,<sup>81</sup> a case often cited by the Canadian courts,

<sup>79</sup> F. R. BATT, *op. cit. supra*, footnote 1, at p. 100.

<sup>80</sup> "As the time of restriction lengthens or the space of its operation grows, the weight of the onus on the covenantee to justify it grows" : per Younger L. J. in *Attwood v. Lamont*, [1920] 3 K.B. 571 (Eng. C.A.), at p. 589.

<sup>81</sup> [1921] 2 A.C. 158, at p. 163. In *Mayer v. Lanthier* (1930-31) 39 O.W.N. 346 (O.H.C.), the defendant, a barber, had agreed not to enter into competition with his employer within a radius of 25 miles of Sudbury for a period of five years after the termination of his employment. Fisher J. said that, considering the nature of the business and Sudbury being a city of 10,000 inhabitants, the restrictive covenant was unreasonable as to time and area. But he added that if the restricted area had been confined to a few blocks or even to half a mile from the plaintiff's shop, the covenant would have been reasonable.

"[...] guidance may be derived in dealing with a restriction relating to time from an examination of the restriction which is made in respect of space. And the converse remark is, of course, equally true".

It must also be mentioned immediately that, according to some writers,<sup>82</sup> consideration is a prominent factor in determining the reasonableness of a restrictive covenant.<sup>83</sup> This view is inaccurate. With respect to the question of consideration in the matter of restrictive covenants, the courts consider only if there is a valuable consideration to support a restrictive covenant as it is essential to support any other contract. The courts do not inquire into the adequacy of consideration<sup>84</sup> and consideration is not an element to which they pay attention when determining reasonableness. For instance, it is well established that the mere giving of employment to a person is a sufficient consideration to support a covenant not to compete,<sup>85</sup> even if the employment is terminable at will,<sup>86</sup> and if the covenantor is already in the employ of the covenantee at the date of the covenant, the continuance of his employment after giving the covenant is also sufficient consideration.<sup>87</sup> But it was recently decided that where a collective agreement is in force and provides for the discharge of an employee only for just cause, the continuance of his employment is not consideration for an agreement by the employee not to solicit the employer's customers for a 12-month period after the termination of his employment because the collective agreement leaves no room for private negotiation of this sort and by retaining the employee the employer does no more than fulfill an existing contract.<sup>87a</sup> Following this reasoning of the Ontario Court of Appeal, it seems that even the giving of employment would not be consideration for a restrictive covenant where a collective agreement

<sup>82</sup> GARE, *op. cit. supra*, footnote 6, p. 46 ; BATT, *op. cit. supra*, footnote 1, p. 110.

<sup>83</sup> "[...] Indeed, it would appear that adequacy of consideration must always be an important-perhaps the most important factor in judging the reasonableness of the covenant". BATT, *ibidem*.

<sup>84</sup> *Supra*, p. 26.

<sup>85</sup> *Sainter v. Ferguson*, (1849) 7 C.B. 716, 137 Eng. R. 283 ; *Mumford v. Gething*, (1859) 7 C.B. (N.S.) 305, 141 Eng. R. 834 ; *George Weston Limited v. Baird*, (1916) 31 D.L.R. 730, 37 O.L.R. 514 (O.C.A.).

<sup>86</sup> *Skeans v. Hampton*, (1914) 31 O.L.R. 424, (1914) 6 O.W.N. 463 (O.C.A.) ; *George Weston Limited v. Baird*, *ibidem*.

<sup>87</sup> *Gravelly v. Barnard*, (1874) L.R. 18 Eq. 518 ; *Hood and Moore's Stores Ltd. v. Jones*, (1899) 81 L.T. 169 ; *Maguire v. Northland Drug Co. Ltd.*, *supra*, footnote 32 ; *Gestetner (Canada) Ltd. v. Henderson*, *supra*, footnote 49 ; *Peerless Laundry and Cleaners Ltd. v. Neal*, *supra*, footnote 48. The courts appear to have admitted that the payment of a pension to an employee upon his retirement or his resignation is a valid consideration for a covenant not to compete : *City Dray Co. Ltd. v. Scott*, *supra*, footnote 41 ; *Furlong v. Burns & Co. Ltd.*, *supra*, footnote 40 ; *Taylor v. McQuilkin*, (1969) 2 D.L.R. (3<sup>d</sup>) 463 (Man. Q.B.).

<sup>87a</sup> *K.M.A. Caterers Ltd. v. Howie*, (1969) 1 D.L.R. (3<sup>d</sup>) 558 (O.C.A.).



similar to that involved in the above case exists. It would therefore be advisable for an employer to include a covenant not to compete in the collective agreement itself.

i) duration of the restraint.

The reasonableness of time limitations will vary with the type of interest to be protected. When the purpose of the covenant not to compete is to protect the employer against the loss of customers, the reasonableness of the time restriction depends to a great degree on the position formerly occupied by the employee in the employer's business, the nature and the intensity of his servicing relationship with customers. For instance, in the case of milkmen or laundrymen who frequently and regularly visit their customers, the service relationship is quite simple and a new employee can get acquainted with the customers in a relatively short period of time. In such cases, six month<sup>88</sup> and one year<sup>89</sup> limitations have been held to be reasonable but limitations extending over one year or one year and a half would probably be considered as greater than necessary for the employer's protection.<sup>90</sup> In other situations, where the employee occupies a position of authority<sup>91</sup> or where the service involves substantial skill<sup>92</sup> or where the business is such that "it takes time to train a successor and for the successor to get to know the customers",<sup>93</sup> a longer time limitation will be allowed. In cases

<sup>88</sup> *Nelsons Laundries Ltd. v. Manning*, *supra*, footnote 48.

<sup>89</sup> *Peerless Laundry and Cleaners Ltd. v. Neal*, *supra*, footnote 48. The employee had covenanted that for a period of 12 months after the termination of his employment he would not "carry on a business similar to that of the company on any territory covered by him during his employment or serve any customer whom he served or whom he has become acquainted while employed by the company".

<sup>90</sup> In *Totem Manufacturing Co. v. Le Drew*, [1924] 3 D.L.R. 340, [1924] 2 W.W.R. 640 (Alb. S.C.), a machinist for the operation and repair of automatic vending machines undertook a covenant not to engage in a similar business for five years in Alberta; Walsh J. decided that the terms of five years was unreasonably long.

<sup>91</sup> In *Lock v. Nelson and Harvey Ltd.*, *supra*, footnote 50, a period of two years in the case of the manager of a custom-brokerage business branch was held reasonable. In *Garbutt Business College Ltd. v. Henderson*, [1939] 4 D.L.R. 151, [1939] 3 W.W.R. 257 (Alb. C.A.), the court approved a time limitation of five years in the case of the principal of a business college.

<sup>92</sup> In *Gestetner (Canada) Ltd. v. Henderson*, *supra*, footnote 49, a two years limitation was allowed in the case of a service representative selling supplies for machines sold by the employer.

<sup>93</sup> In *P.C.O. Services, Ltd. v. Rumleski*, *supra*, footnote 49, a period of two years was considered reasonable in the case of a salesman in the business of providing extermination and pest control services. In *E. P. Chester v. Mastorkis*, *supra*, footnote 49, a two years period was held reasonable for a sales representative in baby products, household gloves, nylon hosiery and other similar products.

of professional employees, like physicians<sup>94</sup> and accountants<sup>95</sup> where the service relationship is complex and the employee acquires a very intimate and personal knowledge of the needs and affairs of customers, and where customers learn to rely to a high degree on the personal skill and attributes of the employees, courts have approved time limitations of five years. No covenant unlimited in time has yet been upheld by the Canadian courts when its object was to prevent loss of customers.<sup>96</sup>

What would be the permissible duration of a restraint when trade secrets are being protected is difficult to establish because there is only one Canadian case on the question and it is not even a case where the employee undertook not to enter into competition with his employer, but rather where the employee only covenanted not to disclose confidential information, trade secrets and secret processes associated with plaintiff's business.<sup>97</sup> It is submitted, however, that a covenant not to compete directed to the protection of a trade secret should be limited in time to the period during which the trade secret keeps its business significance.

ii) area of the restraint.

Whether a covenant not to compete directed to the protection of customer relationships is reasonable as to space will be measured by the location and nature of the employer's clientele and by the area of the employer's business activities.

When the employer's product or service is purveyed primarily at his place of business, the geographical area from which the bulk of clientele is drawn is a practicable way to define an effective restraint and restraints not extending beyond this geographical area have generally been held reasonable by the Canadian courts. In *Deacon v. Crehan*,<sup>98</sup> the defendant, a physician, had covenanted not to engage in the practice

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<sup>94</sup> *Deacon v. Crehan*, [1925] 4 D.L.R. 664, (1925) 57 O.L.R. 597, (1925) 29 O.W.N. 34 (O.S.C.); *Hall v. More*, *supra*, footnote 51; *Mills v. Gill*, *supra*, footnote 51.

<sup>95</sup> *Campbell, Imrie and Shankland v. Park*, *supra*, footnote 51.

<sup>96</sup> In *American Building Maintenance Co. Ltd. v. Shandley*, *supra*, footnote 41, a covenant by a managerial employee not to solicit his employer's customers in certain areas was held invalid because it was unlimited in time. In some cases, employee covenants unlimited as to time have been held valid in England: *Fitch v. Dewes*, *supra*, footnote 81. See also GARE, *op. cit. supra*, footnote 6, p. 44.

<sup>97</sup> *Reliable Toy Co. Ltd. and Reliable Plastics Co. Ltd. v. Collins*, [1950] 4 4 D.L.R. 499, [1950] O.R. 360, (1950) O.W.N. 329, 11 Fox Pat. C. 5 (O.H.C.). The covenant was held reasonable and valid.

<sup>98</sup> *Supra*, footnote 94.

of medicine within a radius of ten miles of the city of Stratford for five years. Wright J. said that the covenant was not too large in area because the employer's practice extended in all directions in the country around Stratford to at least ten miles. In *Mills v. Gill*,<sup>99</sup> the defendant, a physician, had agreed not to practice medicine within the city of Oshawa or within five miles thereof for five years. McLennan J. held that the covenant was reasonable with respect to space because "the practice covers an area of twenty-five miles beyond the city limits of Oshawa, and the area in which the restraint is effective is only five miles". Such a covenant, as we can see, protects an employer, not only against his actual trade connection, but also from competition by his employees with respect to many potential customers unconnected with him, particularly when the area is populous. Is it not to give the employer much more protection than he is entitled to under the protectible proprietary interest theory? The court thought so in a recent case, that of *Gordon v. Ferguson*.<sup>100</sup> The defendant, still a physician, had undertaken not to "... engage in the practice of medicine or surgery similar to that now carried on by the employer [...] within the town of Dartmouth [...] and a radius of twenty miles from the boundaries thereof [...]". MacDonald J. A., rendering the judgment for the majority of the Nova Scotia Court of Appeal, stated :

"[...] the restriction [...] has the effect of preventing the employee from professional dealings with prospective patients in the area in question without any limitation as to whether they had or had not any previous connection with the practice of the employer or had or had not been brought into contact with the employee in the course of his services. In this sense, I think that the prohibition against the practice of medicine, etc., is excessive in that it precludes the employee from dealing with persons unconnected with the practice of the employer before or during the currency of the agreement, including persons who have moved into the area in question since the termination of the agreement. This is a clear ground of invalidity".<sup>101</sup>

When a covenant is undertaken by an employee who deals with and services customers along a route or through a large territory, restrictions extending beyond the area in which the employer has or solicits clients is obviously always unreasonable.<sup>102</sup> And though one case<sup>103</sup> has allowed a restraint as broad as the entire area of the employer's

<sup>99</sup> *Supra*, footnote 51, at p. 37 (D.L.R.).

<sup>100</sup> *Supra*, footnote 66.

<sup>101</sup> *Ibid.*, at p. 183 (M.P.R.).

<sup>102</sup> *Harvison v. Cornell*, (1906) 8 O.W.R. 697 (O.S.C.) ; *Lovell v. Pearson*, (1914) 17 D.L.R. 856 (O.S.C.) ; *Allen Manufacturing Co. v. Murphy*, *supra*, footnote 74 ; *New Method Cleaners and Launderers Ltd. v. Hartley*, *supra*, footnote 48.

<sup>103</sup> *Skeans v. Hampton*, *supra*, footnote 86.

business activities, regardless of the employee's activities, the general rule is now that the geographical extent of a restriction, to be reasonable, must be confined to the area or territory in which the employee was active.<sup>104</sup>

Even if a restriction is limited to the area in which the employee carried on his activities, it is submitted that it should be declared unreasonable on the ground that it affords more than adequate protection for the proprietary interests of the employer. As said MacDONALD J. A. in *Gordon v. Ferguson*<sup>104a</sup> it is excessive to preclude an employee from dealing with potential customers or persons unconnected with the employer's business before or during the currency of the contract of employment.<sup>105</sup> If the courts want to apply correctly the general principle laid down in the *Herbert Morris* case to the effect that a restrictive covenant is reasonable in so far as it affords no more than adequate protection to the employer, it seems that in all cases in which such a covenant is designed to protect the employer against loss of customers, it should only prohibit the employee from doing business or soliciting customers with whom he dealt or at most the employer's actual customers. In so far as an employee has not had contacts with potential customers in a certain territory, to enforce a restraint covering this whole territory seems to be an justifiable restraint to competition.<sup>106</sup>

iii) scope of prohibited activities.

To determine the reasonableness of a restrictive covenant undertaken by an employee, the courts also consider the scope of business activities prohibited to the employee. In *Gibson v. Campbell*,<sup>107</sup> for instance, the defendant had agreed not to engage in "any line of business" in the town of Woodstock without first obtaining the plaintiff's consent. Hazen C. J. held that this went beyond what was reasonably necessary for the protection of the plaintiff from the rivalry of the defendant in the jewelry business. Many other cases have made it clear that a restric-

<sup>104</sup> *Dominion Art Co. Limited v. Murphy*, (1923) 54 D.L.R. 332 (O.C.A.); *Skeans v. Keegan*, *supra*, footnote 48; *Peerless Laundry and Cleaners Ltd. v. Neal*, *supra*, footnote 48; *P.C.O. Services Ltd. v. Rumieski*, *supra*, footnote 49.

<sup>104a</sup> *Supra*, footnote 66.

<sup>105</sup> In *George Weston Limited v. Baird*, *supra*, footnote 85, Meredith C. J. expressed similar views when he said, at p. 731 (D.L.R.): "[...] what justification for any restraint beyond what would prevent the defendant taking advantage of the trade to which his connection with the plaintiffs introduced him, or, more plainly put, those who were really the plaintiff's customers?"

<sup>106</sup> In *Gleahow Autoparts Ltd. v. Delaney*, [1965] 1 W.L.R. 1366 (Eng. C.A.), the Court adopted such a view.

<sup>107</sup> (1921-22) 49 N.B.R. 185 (Ch. D.).

tion which is wider than the particular business or professional activities carried on by the employer at the time the covenant is entered into is unreasonable.<sup>108</sup> In *R. C. Young Insurance Ltd. v. Bricknell*,<sup>109</sup> the defendant covenanted not to carry on the business of an insurance agent in certain places for a period of three years. Laidlaw J. A. said :

"It is not in dispute that the appellant company did not carry on every kind of business of insurance. There were many kinds of business that were not carried on by it, but nevertheless it seeks a declaration that not only would prohibit the respondent from carrying on the kind or kinds of business carried on by it at the time the agreement was entered into but would prevent the respondent from carrying on business that the employer did not carry on [...]. We are satisfied that the clause goes far beyond what was reasonably necessary and permitted in law".<sup>110</sup>

Does it follow that a covenant which is not wider than the employer's business activities at the time it is entered into may always be valid, even if the job the employee holds is limited to a specialized or particular activity within the employer's business activities? In *Mills v. Gill*,<sup>111</sup> the defendant had agreed not to "engage in the practice of medicine, surgery or in any branch thereof . . ." after the termination of his employment. The defendant submitted that since he had been hired primarily as a surgeon, a covenant to be enforceable against him would have to be confined to surgery, or at the most surgery and general medicine, and because the covenant covered every branch of medicine and surgery it went beyond what was necessary to protect the plaintiff's interests. McLennan J. stated that the test was :

"whether the covenant was wider than the actual business or practice, and not whether the covenant covered a wider field than the work for which the covenantor was hired".<sup>112</sup>

This sweeping statement seems questionable in some situations. When the employer is a company with highly diversified activities, it would, in our opinion, be unreasonable to attempt to restrain the employee who works in a particular department or in a special activity from engaging or being interested in any business similar to that carried on

<sup>108</sup> *William Shannon Co. v. Crane*, (1915) 25 D.L.R. 843 (O.S.C.); *Mills v. Gill*, *supra*, footnote 51; *Carruthers Clinic Ltd. v. Heraman*, (1956) 5 D.L.R. (2<sup>d</sup>) 492, [1956] O.R. 770 (O.H.C.); see also to the same effect: *Routh v. Jones*, *supra*, footnote 47.

<sup>109</sup> [1955] 5 D.L.R. 490, [1955] O.W.N. 638, (1955) 23 C.P.R. 73 (O.C.A.).

<sup>110</sup> *Ibid.*, at p. 491 (D.L.R.), Meredith C. J. also indicated in *George Weston Ltd. v. Baird*, *supra*, footnote 85, at p. 731 (D.L.R.), that it would be unreasonable to prohibit a route man from dealing in products which were no part of his employer's trade.

<sup>111</sup> *Supra*, footnote 51.

<sup>112</sup> *Ibid.*, at p. 36 (D.L.R.).

by the employer. It is submitted that to secure no more than adequate protection for the employer's interest, a restraint should be confined to the business activities carried on by the employee during the currency of his employment agreement.<sup>113</sup>

b) *covenants included in contracts of sale of businesses.*

A covenant not to compete ancillary to the sale of a business is reasonable if the restraint imposed upon the seller is no greater than necessary for the protection of the goodwill of the business sold. The principal practical tests by which courts determine the reasonableness of such a covenant are, as in contracts of employment, the duration of the restraint, its geographical extent and its scope.<sup>114</sup>

i) duration of the restraint.

The courts pay attention to the time restriction in determining the reasonableness of a restrictive covenant between a buyer and a seller, but they consider it as a secondary factor. In *Connors Bros. Ltd. v. Connors*,<sup>115</sup> Viscount Maugham stated :

"If the restriction as to space is considered to be reasonable it is seldom in a case where the sale of a goodwill is concerned that the restriction can be held to be unreasonable because there is no limit as to time".

An examination of the Canadian cases confirms this proposition. Many covenants unlimited as to time have been upheld<sup>116</sup> and covenants extending to five or ten years have been commonly held valid.<sup>117</sup> In

<sup>113</sup> See : *Commercial Plastics Ltd. v. Vincent*, [1964] 3 All E.R. 546 (Eng. C.A.); *T. S. Taylor Machinery Co. Ltd. v. Biggar*, *supra*, footnote 55a, at p. 289.

<sup>114</sup> Most Canadian cases involving covenants not to compete incident to transfers of businesses may be found in *CRYSLER, op. cit. supra*, footnote 53. But the cases are only summarized one after another without any analysis. Let us mention that restrictive covenants found in partnership agreements are treated by the courts like covenants incident to sales of businesses. See : *Houghton v. Evans*, [1925] 3 D.L.R. 109, (1925) 35 B.C.L.R. 25, [1925] 2 W.W.R. 248 (B.C.S.C.); *Lerik v. Zaferis*, (1928-29) 41 B.C.L.R. 249 (B.C.C.A.); *Sotiroff v. Dimitroff, supra*, footnote 70 ; *Green v. Stanton*, (1969) 3 D.L.R. (3d) 358.

<sup>115</sup> [1941] 1 D.L.R. 81, [1941] 3 W.W.R. 666, [1940] 4 All E.R. 179 (P.C.), at p. 98 (D.L.R.).

<sup>116</sup> *Mizon v. Pohoretzky, supra*, footnote 74 (grocery business); *Baird v. Jones*, (1919-20) 47 N.B.R. 31 (Ch. D.) (an electrical business); *Markson v. Rosenberg*, [1928] 1 D.L.R. 1009, (1928) 61 O.L.R. 558 (O.C.A.) (a retail business); *Connors Bros. Ltd. v. Connors, ibid.*; *Cope v. Harasimo*, (1965) 48 D.L.R. (2d) 744, 50 W.W.R. 639, 47 C.P.R. 36 (B.C.C.A.), affirming (1964) 46 W.W.R. 376 (a hairdresser business).

<sup>117</sup> See for instance : *Griffey v. Watts*, (1924) 25 O.W.N. 157 (O.S.C.); *Greening Industries Ltd. v. Penny*, (1966) 53 D.L.R. (2d) 643 (N.S.S.C.).

no case has a covenant been considered as unreasonable because of the time factor.<sup>118</sup> It is submitted that courts should give more importance to the duration of a restraint to determine its reasonableness and not allow a time period greater than is necessary for the buyer to establish himself favourably with his predecessor's customers. This standard could vary with the type of business involved. In the case of a retail business, like a grocery store, where customers patronize the business at short intervals, the buyer can establish an advantageous position with them in a short duration of time and a relatively short period of protection should be accepted. A covenant unlimited in time should therefore be held unreasonable and void. On the other hand, in the case of professional practices, where the personal attributes of the practitioner are of great importance and relations with customers are often unfrequent, a longer time period is required for the buyer to gain the confidence and respect of customers and a greater period of protection should be allowed.

ii) geographical extent of the restraint.

A perusal of Canadian common law cases on the subject shows that a covenant not to compete incident to the transfer of a business is held reasonable as to its geographical extent if it is confined to the area within which the subsequent establishment of a similar business by the seller would, in all probability, injure the purchaser.<sup>119</sup> The boundaries of this area are not strictly and severely scrutinized by the courts ; even a world-wide covenant may be held reasonable if, taking into account the nature of the business, the conditions and the extension of the market and the wide distribution of the customers, it is deemed necessary to enable the purchaser to reap the full benefit of his contract. In the *Nordenfelt* case,<sup>120</sup> for instance, a world-wide covenant undertaken by the seller of a business consisting in the manufacture of guns and ammunition was held reasonable because of the limited number of customers distributed over the world.

It is not necessary, according to Viscount Maugham's dictum in the *Connors* case,<sup>121</sup> that the business which the covenant is designed to protect has been carried on in every part of the area mentioned in

<sup>118</sup> In *Newhook v. Elson*, (1960) 44 M.P.R. 258 (Nfld S.C.), Winter J. found that the covenant not to compete undertaken by the defendant was void for lack of consideration but added that it could have been considered as unreasonable if only because unlimited in time.

<sup>119</sup> *Connors Bros Ltd. v. Connors*, *supra*, footnote 115, at pp. 9798 (D.L.R.).

<sup>120</sup> *Supra*, footnote 20.

<sup>121</sup> *Supra*, footnote 115.

the covenant. In this case, L. and B. Connors sold their shares in Lewis Connors and Sons, Ltd., a sardine canning company, to Connors Bros. Ltd. and agreed not to engage in any other sardine business in the Dominion of Canada. The business was located in New Brunswick but its products were sold throughout Canada. Viscount Maugham, delivering the judgment, said :

“In a country of vast spaces like the Dominion of Canada it will always be possible [...] to point to areas where there are only few settlers or inhabitants and where accordingly few if any of the goods sold by the manufacturer have penetrated but the goodwill of a business such as is now under consideration could not adequately be protected if the restrictive covenant had to be limited to the towns and villages where actual sales could be proved whilst leaving the vendor free to establish a business which would almost certainly be competitive, in all the adjoining places”.<sup>122</sup>

The covenant was consequently held reasonable. In *Houghton v. Evans*,<sup>123</sup> plaintiff and defendant carried on business in partnership as engravers and manufacturers of dies, stencils, rubber stamps and similar articles. The work was performed in the city of Victoria, but the products were distributed over the whole province of British Columbia. A covenant not to engage in a similar business for five years in the province, contained in the dissolution of the partnership agreement, was held reasonable. From these cases, it would appear that if a restrictive covenant is entered into in connection with the sale of a manufacturing business, it can geographically extend to the entire area in which the manufactured products are distributed.

In a recent case,<sup>124</sup> however, the court did not wholly apply this rule. The defendants had sold their company which manufactured synthetic ropes and distributed its product in the Maritime Provinces and Central Canada and had agreed not to engage in a similar business within determined Provinces which in fact covered the whole Canada. Bisset J. severed the covenant and limited its geographical extent to the Maritimes Provinces in which, he said, a large part of the business sold was concentrated, and in which the competing business established by the defendants was situated. It seems that to give an adequate protection to the purchaser in this case, the covenant should have covered also Central Canada where the company distributed part of its manufactured goods.

If other types of businesses are involved, like grocery and restaurant businesses or a business of servicing and maintaining electrical equip-

<sup>122</sup> *Ibid.*, at p. 97 (D.L.R.).

<sup>123</sup> *Supra*, footnote 114.

<sup>124</sup> *Greening Industries Ltd. v. Penny*, *supra*, footnote 117.



ment, a covenant protecting the buyer within the town in which the business is located is reasonable.<sup>125</sup> In *Cope v. Harasimo*<sup>126</sup> a person wellknown in the community sold his hairdressing business located in Campbell River to a newcomer. A covenant not to engage in a similar business within a radius of twenty-five miles from the business premises was considered as reasonable. But in *Re Giannone and Stampeder Motor Hotel Ltd.*,<sup>127</sup> where the seller of a hotel agreed not to engage in the same business in Calgary or within fifteen miles of that city, the covenant was held to extend beyond an area within which the vendor might in all probability injure the purchaser.<sup>128</sup>

It is important to note that the reasonableness of a covenant must be judged by the extent of the business sold only. In *McAllister v. Cardinal*,<sup>129</sup> Stewart J. stated clearly :

"It is to be noted that in determining the question of the reasonableness of the area the restraint must be for the protection of the business sold and in which the covenantee has an interest, but is not to be judged by the extent and circumstances of any other business, of which, after transfer, the business sold becomes a part [...]. It would be quite unreasonable, for example, to protect the Canada — wide activities of Imperial Oil Limited if Cardinal had sold his business to that corporation. I hold therefore that a contract which restrains trade in an area wider than is necessary to protect the purchased business as it then was cannot be validated by the subsequent acquisition of other similar businesses in the unreasonably extended areas".

iii) scope of the restraint.

A covenant not to compete accompanying the sale of a business must also be limited in its scope to the kind of business sold to be reasonable. The seller of a business cannot be restrained from engaging in "any kind" of business. In *Latimer v. Fontaine*,<sup>130</sup> a covenant not to engage "in any business" was held wider in scope than necessary for the protection of the covenantee. In some cases, it happened that the

<sup>125</sup> *Lerik v. Zaferis*, *supra*, footnote 114 (restaurant); *Markson v. Rosenberg*, *supra*, footnote 116 (retail business); *Fluorescent Sales and Service Ltd. v. Bastien*, (1962) 39 W.W.R. 659 (Alb. S.C.) (electrical equipment); *Mizon v. Pohoretzky*, *supra*, footnote 74 (grocery store).

<sup>126</sup> *Supra*, footnote 116.

<sup>127</sup> (1964) 41 D.L.R. (2<sup>d</sup>) 242 (Alb. S.C.).

<sup>128</sup> Other cases involving covenants incident to a sale of business: *Ryder v. Lightfoot*, (1965) 51 D.L.R. (2<sup>d</sup>) 83 (N.S.S.C.); *Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*, [1954] 2 D.L.R. 154, (1954) 11 W.W.R. 254, (1954) 62 Man. R. 148 (Man. C.A.).

<sup>129</sup> (1965) 47 D.L.R. (2<sup>d</sup>) 313, (1965) 1 O.R. 221, (1966) 47 C.P.R. 28 (O.H.C.), at p. 319 (D.L.R.). See to the same effect: *Greening Industries Ltd. v. Penny*, *supra*, footnote 117 at p. 652.

<sup>130</sup> [1905] 2 W.L.R. 191.

court, taking into account particular circumstances, interpreted a widely drafted covenant so as to limit its scope. In *Baird v. Jones*,<sup>131</sup> the defendant had sold his electrical business to the plaintiff and has undertaken "not to do business" in the city of St. John. The court held that the words "not to do business" were limited to the electrical business referred to in the agreement and that the covenant was reasonable. It is doubtful if such a reduction of the scope of a covenant would still be made today and it is submitted that it is more cautious always to specify the kind of business which the covenantor is forbidden to carry on. This specification may be made directly by mentioning expressly the kind of business involved or indirectly by saying . . . "the seller agrees not to carry on any business similar to or competing with that sold". However, it is not necessary that the seller be prohibited only from carrying on himself the kind of business mentioned; the seller may also be lawfully restrained from working as an employee or from holding shares in a company carrying on a competing business.<sup>132</sup>

#### 4 - Point of time of reasonableness.

It is easy to imagine circumstances which may convert a covenant not to compete, which is reasonable at the time it is undertaken, into an unreasonable covenant, or vice versa. It would not be unnatural to imagine that the point of time chosen to assess the reasonableness of a covenant would be the date at which it is considered by the tribunal. But such does not seem to be the view taken by the courts. Many English decisions have made it clear that the essential date is the date of the making of the contract or entering into the covenant.<sup>133</sup> And the Canadian courts seem to share this opinion. In *Mills v. Gill*,<sup>134</sup> Stewart J., relying on English cases, stated that the material date to consider in determining whether a covenant is reasonable or not is the date of the making of the contract.<sup>135</sup>

<sup>131</sup> *Supra*, footnote 116. See also *Mizon v. Pohoretzky*, *supra*, footnote 74, at p. 214.

<sup>132</sup> *Kelly v. McLaughlin*, (1911) 1 W.W.R. 309, (1911) 19 W.L.R. 633, (1911) 21 Man. R. 789 (Man. C.A.); *Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*, *supra*, footnote 128; *Greening Industries Ltd. v. Penny*, *supra*, footnote 117; *Ronbar Enterprises Ltd. v. Green*, [1954] 2 All E.R. 266, 1 W.L.R. 815.

<sup>133</sup> See GARE, *op. cit. supra*, footnote 6, pp. 27 *et seq.*; MOLLER, *op. cit. supra*, footnote 6, p. 61.

<sup>134</sup> *Supra*, footnote 51, at p. 31 (D.L.R.).

<sup>135</sup> See also *McAllister v. Cardinal*, *supra*, footnote 129. A recent English case is to this effect: *Commercial Plastics Ltd. v. Vincent*, [1964] 3 All E.R. 546 (C.A.), at p. 553.

### 3. *Absence of injury to the interests of the public*

Even if a covenant not to compete contained in a contract of employment or sale of a business is reasonable between the parties, it may still be invalidated if it is in some way injurious to the public.<sup>136</sup> It is essential that a covenant not to compete be, in all respects, consistent with the interests of the public.<sup>137</sup> So far, however, the Canadian courts have never held that a restrictive covenant which was reasonable between the parties was void because it caused some injury to the public,<sup>138</sup> and it is difficult to imagine situations in which they would decide differently. They have rejected, for instance, the contention that it is contrary to the public interests to deprive a certain community of the personal services of a professional man like a physician. In *Mills v. Gill*,<sup>139</sup> the restrained employee, a physician, urged that even if the covenant was reasonable between the parties, it was contrary to the public interest to prohibit him, a specialist, from practising in Oshawa, on the ground that a portion of the public would be deprived of his services. Stewart J. held that there was no injury to the public since the plaintiff, the employer, was able to replace the defendant with a medical practitioner with qualifications equal to those of the defendant.<sup>140</sup> Would the result have been different if the defendant had practised in a field of medicine in which there were very few specialists, so that it would likely have been very difficult for the employer to repla-

<sup>136</sup> "The first question in every case is whether the restraint is reasonable in the interests of the parties. If it is not, the restraint is bad. If it is, it may still be shown that it is injurious to the public...": per Lord Parker of Waddington, in *Herbert Harris Ltd. v. Saxelby*, *supra*, footnote 5, at p. 708. See also at p. 700, per Lord Atkinson.

<sup>137</sup> *Cope v. Harasimo*, *supra*, footnote 116; *Furlong v. Burns*, *supra*, footnote 40; BATT, *op. cit. supra*, footnote 1, p. 109. "Interests of the public" or "public interest" must not be confounded with "public policy". A covenant not to compete which is unreasonable between the parties will be held void as being against public policy even if it is not in fact detrimental to the interest of the public.

<sup>138</sup> "I know of no case that holds that if the covenant is fair and reasonable in the interests of the parties, it can be inimical to the public interest": Per Bissett J. in *Greening Industries Ltd. v. Penny*, *supra*, footnote 117, at p. 654. Only one much criticized English decision has pronounced void a restrictive covenant between employer and employee on the ground that it was injurious to the interests of the public: *Wyatt v. Kreglinger & Fernau*, [1933] 1 K.B. 793, commented: (1933) 49 *L.Q.R.* 465. It appeared to the court that the contract was injurious to the public since to restrain the employee from engaging in the wool trade was to deprive the community from services from which it might derive advantages.

<sup>139</sup> *Supra*, footnote 51.

<sup>140</sup> *Ibid.*, at p. 38. A similar reasoning is found in *Green v. Stanton*, (1969) 3 D.L.R. (3d) 358.

ce him and to offer the same professional services to the public? It is impossible to answer categorically, but we may infer from the statement of Stewart J. that in such a case the courts' reluctance to strike down as injurious to the public a covenant reasonable in other respects might have been overcome. In *Campbell, Imrie and Shankland v. Park*,<sup>141</sup> it was said that a covenant restraining an accountant from working in a certain town was not injurious to the public since there were other accountants in the town which were ready to serve the public. And in *Cope v. Harasimo*,<sup>142</sup> the defendant had sold her hair-dressing business in Campbell River and had subjected himself to a restrictive covenant. The trial judge stated :

"the evidence shows that Campbell River is and was at the date of the agreement copiously supplied with beauty parlours. The keenest competition existed and exists. It has not been demonstrated to me that Mary Harasimo's qualifications are of so superior a kind that the public will be injuriously affected by deprivation of her services. [...] I cannot see what possible harm could have been done to the public [...]".<sup>143</sup>

Furthermore, the plea that a restrictive covenant accompanying the sale of a business would permit the covenantee to monopolize a business is not likely to succeed. In *Connors Bros. Ltd. v. Connors*,<sup>144</sup> the Privy Council held :

"When the court is satisfied that the restraint is reasonable as between the parties it must always be very difficult to prove in a case connected with goodwill that the public interest is affected. In the present case it seems to their Lordships that there are no grounds for holding that a restriction restraining the respondent from carrying on a sardine business in Canada is likely to produce a real monopoly, since every other person in Canada can set up such a business and the evidence is to the effect that some persons have done so".

The rule that a covenant not to compete, notwithstanding its reasonableness between the parties, may still be held void if it is injurious to the public is therefore a pious theoretical formulation originating from Lord Macnaghten's speech in the *Nordenfelt* case which has had no practical application afterwards. In fact, the validity of a covenant not to compete in Canadian common law has been based, so far, on a twofold test : firstly, the existence of a protectible proprietary interest

<sup>141</sup> *Supra*, footnote 31. See also *Canadian Linen Co. Ltd. v. Graham*, [1937] 3 W.W.R. 326, 52 B.C.R. 287 (B.C.S.C.).

<sup>142</sup> *Supra*, footnote 77.

<sup>143</sup> *Ibid.*, at p. 380.

<sup>144</sup> *Supra*, footnote 115, at p. 98 (D.L.R.).

on the part of the covenantee and, secondly, the reasonableness of the covenant between the parties.

## B. Proof

### 1. *Onus of proof*

Canadian common law courts still consider freedom of trade and freedom of work as paramount elements of public policy which outweigh freedom of contract. They continuously reaffirm Lord Macnaghten's old view that prima facie all covenants in restraint of trade are illegal and void as contrary to public policy but may be justified if they are reasonable in the interests of the parties and not inconsistent with the interests of the public.<sup>145</sup> It is therefore up to the party seeking enforcement of a covenant, that is to say the covenantee, to rebut this presumption of illegality by proving that he has a proprietary interest to protect and that the restriction goes no further than necessary to secure adequate and reasonable protection.<sup>146</sup> The onus of showing that, notwithstanding its character of reasonableness between the parties, a covenant is nevertheless injurious to the interests of the public rests evidently on the covenantor. Wilson C. J. accurately described the actual reasoning of the courts with respect to onus of proof when he said in *Cope v. Harasimo*,<sup>147</sup> a sale of business case :

"[. . .] I should first decide if the plaintiff has discharged the onus of proving that the covenant is reasonable at between the parties concerned. If it is not, that is the end of the matter. If, however, on this first question my finding is affirmative, then I must next decide whether or not the defendant Mary Harasimo has proved that the covenant is injurious to the public".

<sup>145</sup> *Maguire v. Northland Drug Co. Ltd.*, supra, footnote 32 ; *American Building Maintenance Co. Ltd. v. Shandley*, supra, footnote 41 ; *Cope v. Harasimo*, supra, footnote 116 ; *Gordon v. Ferguson*, supra, footnote 66 ; *E. P. Chester Ltd. v. Mastorkis*, supra, footnote 49. In *McAllister v. Cardinal*, supra, footnote 129 at p. 317 (D.L.R.), Stewart J. seemed to wish that a greater importance be accorded to freedom of contract : "I would gladly grant the declaration prayed for if I felt able to do so, for Cardinal was paid handsomely for his non-competitive covenant and knew precisely what he was doing when he agreed to it, but I am bound by authorities which, as I read them, prevent my so doing. Unfortunately, Cardinal is not estopped either by receipt of adequate consideration or by its acquiescence in the terms of the agreement from denying its validity. This would appear to stem from the early concept that all contracts in restraint of trade were void as being against public policy [. . .]".

<sup>146</sup> *Northern Messenger and Transfer Ltd. v. Fabro*, supra, footnote 61 ; *Colonial Broadcasting System Ltd. v. Russell*, supra, footnote 41 ; *Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*, supra, footnote 128.

<sup>147</sup> *Supra*, footnote 77, at p. 376.

## 2. *Admissibility of evidence*

It is well established that the question of whether a covenant not to compete is reasonable or not is a question of law for the court.<sup>148</sup> Consequently, it is beyond the competence of a jury to determine the reasonableness of a covenant ; if there is a jury, its sole function is to find and ascertain such facts as are necessary in the circumstances to enable the court to render a decision.<sup>149</sup> It also follows that the court will not permit expert evidence to be given by people engaged in a trade for the purpose of showing whether or not a covenant connected with that trade is, in their opinion, reasonable.<sup>150</sup> This does not mean, however, that all evidence by persons engaged in the same trade is inadmissible. As Lord Haldane said in the *Mason* case,<sup>151</sup> evidence as to any practice which is usual among businessmen is admissible "not because this can determine the legal question of what is reasonable, but because what is usual is to some extent a guide in the consideration of the requirements of the particular business".

Thus, evidence is admissible on the question of reasonableness so long as it deals with facts of known trade usages ; but no evidence is admissible which is in reality a statement of opinion by a witness upon the reasonableness of the covenant before the court.<sup>152</sup>

## Conclusion

In discussing the validity of covenants not to compete, we have referred only to cases involving covenants contained in a contract of service or accompanying the transfer of a business. Yet we also find restrictive covenants in other types of contracts, particularly in contracts of lease and in partnership agreements. The reported cases involving these kinds of covenants are very few and the courts have relied on and applied the same principles as those developed in decisions rendered in matters of contracts of employment or sales of businesses. As we previously mentioned,<sup>153</sup> covenants included in a partnership agreement

<sup>148</sup> *Mason v. Provident Clothing and Supply Co. Ltd.*, *supra*, footnote 24 ; *Connors Bros. Ltd. v. Connors*, *supra*, footnote 116 ; *Gordon v. Ferguson*, *supra*, footnote 66.

<sup>149</sup> CHESHIRE and FIFOOT, *op. cit. supra*, footnote 27, p. 315.

<sup>150</sup> *Haynes v. Doman*, [1899] 2 Ch. 13, at p. 24 ; *Sir W. C. Leng and Co. v. Andrews*, [1909] 1 Ch. 763, at p. 770.

<sup>151</sup> *Supra*, footnote 24, at pp. 732-733.

<sup>152</sup> GARE, *op. cit. supra*, footnote 6, p. 27 ; CHESHIRE and FIFOOT, *op. cit. supra*, footnote 27, p. 315.

<sup>153</sup> *Supra*, footnotes 70 and 114.

or entered into by retiring partners at the time of their retirement are treated by the courts exactly like covenants undertaken by sellers of businesses. A covenant undertaken by a person who leases a business which it is carrying on is also treated like a covenant accompanying the transfer of a business.<sup>154</sup> The validity of covenants by the lessor of a building not to carry on or not to permit adjacent or neighbouring premises to be used for a business similar to that of the lessee has never been questioned by the courts ; so far, in the cases involving these types of covenants, only problems relating to the interpretation and enforcement<sup>155</sup> have been dealt with. Should the question of validity be raised in such cases, we submit that the courts ought to abide by the principle of reasonableness as defined and applied in sales of businesses cases.

Let us finally mention that it is not uncommon for the vendor of a piece of land to insert into the conveyance a clause providing that the purchaser shall not carry on a specified kind of business or trade upon the land conveyed. Such covenants, being confined to a small area, have never been struck down as unreasonable and against public policy<sup>155a</sup> even when they were unlimited in time.<sup>156</sup>

## Part II

### Severance of covenants not to compete

It may happen that a restraint taken as a whole be too broad to be reasonable, but that a part of it, taken alone and separately, be reasonable and valid. In common law, it is considered that the good is not necessarily vitiated by the bad and that if it can be severed from it, it will be enforced by the courts.

The doctrine of severance, which "is not peculiar to contracts and covenants in restraint of trade but is, in fact, common to the law of

<sup>154</sup> *Jones v. Heavens*, (1877) 4 Ch. D. 636. See also : *Ryan v. McNicholl*, (1897) 34 N.B.R. 391 (C.A.).

<sup>155</sup> *Moorman v. Schemmer and Dalton*, (1960) 21 D.L.R. (2<sup>d</sup>) 470 (O.H.C.); *Stop and Shop Ltd. v. Independent Builders Limited*, [1933] O.R. 150, [1933] 1 D.L.R. 727 (O.S.C.); *Labone v. Litherland Urban District Council*, [1956] 2 All E.R. 215.

<sup>155a</sup> *Wanek v. Thols*, [1928] 1 W.W.R. 903, (1928) 23 Alb. L.R. 602, [1928] 2 D.L.R. 793 (Alb. S.C.); *Can. Construction Co. v. Beaver (Alberta) Lumber Ltd.*, [1955] 3 D.L.R. 502 (S.C. of C.); *Colonial and Home Fuel Distributors Ltd. v. Skinner's Ltd.*, (1963) 39 D.L.R. (2<sup>d</sup>) 579 (Man. Q.B.).

<sup>156</sup> *Re : Bowes Co. and Rankin*, [1924] 4 D.L.R. 406, (1924) 55 O.L.R. 601 (O.C.A.).

contract”<sup>157</sup> has had a long and chequered career and its application to restrictive covenants still remains a “very vexed and difficult question”.<sup>158</sup> It was first applied to covenants in restraint of trade in the early English decision of *Chesman v. Nainby*.<sup>159</sup> There, an employee in a linen-drapery shop covenanted not, at any time after her employment, “to set up or exercise the trade or mystery of a linen draper [. . .] in any shop, room or place within the space of half a mile of the said now dwelling house of [her employer . . .] situate in Drury-Lane, or of any other house that she [her employer . . .] shall think proper to remove to [. . .]”.

Because the employer might move anywhere, the restraint was regarded as too broad and then invalid as written. However, the court found that the covenant was severable; it struck out the clause restraining the employee from competing in “any other house that she shall think proper to remove to” and issued an injunction covering the half-mile area around plaintiff’s then place of business.

Starting from this case, there is, through the centuries, a long line of English cases in which restrictive covenants, contained either in contracts of employment or in vendor-purchaser agreements, have been severed with respect to area or kind of activities prohibited to the covenantor,<sup>160</sup> and the unqualified affirmation that “before 1930 courts in most common law jurisdictions rejected severability”<sup>161</sup> seems inaccurate. As a result of the English decisions, it appears that severance is permitted if a covenant consists of two or more distinct and separate parts and if the unreasonable parts may be struck out without impairing the substantial meaning of the covenant or altering the intention of the parties.<sup>162</sup>

In the Canadian law, despite Mr. Justice MacDonald’s dictum<sup>163</sup> that, on the question of severability, guidance “in a matter so largely

<sup>157</sup> F. A. GARE, *op. cit. supra*, footnote 6, p. 65.

<sup>158</sup> F. R. BATT, *op. cit. supra*, footnote 1, p. 110.

<sup>159</sup> (1727) 1 Bro. Parl. Cas. 234, 1 Eng. R. 536 (H. of L.).

<sup>160</sup> For a complete discussion of the origin and development of the English law on the subject of severance, see: Norman S. MARSH, “The Severance of Illegality in Contract”, (1948) 64 *L.Q.R.* 230, 347, and (1953) 69 *L.Q.R.* 111; F. A. GARE, *op. cit. supra*, footnote 6, p. 65. Severance is also discussed by C. J. W. FARWELL, “Covenants in Restraint of Trade as Between Employer and Employee”, (1928) 44 *L.Q.R.* 66. American courts also permit severance: Gary L. BRYENTON, *loc. cit. supra*, footnote 22, at pp. 178, 188.

<sup>161</sup> Emilio S. BINAVINCE and Robert CHIARELLI, “Recent developments in Canadian law-contract”, (1966) 1 *Ottawa L.R.* 148, at p. 169.

<sup>162</sup> CHESHIRE and FIFOOT, *op. cit. supra*, footnote 27, p. 326; ANSON, *op. cit. supra*, footnote 34, p. 356; *Halsbury’s Laws of England*, 3<sup>rd</sup> ed., vol. 38, p. 53.

<sup>163</sup> *Gordon v. Ferguson*, *supra*, footnote 66, at p. 186.



one of public policy — is to be sought in the Canadian rather than in the English decisions as more likely to reflect what is adapted to our conditions”, the courts have referred to and applied the rules established by English jurisprudence.

Thus, the courts permit severability only if the provisions of a covenant are, by their very terms, distinct and separate. If an unreasonable covenant is found to be indivisible, it entirely fails. The courts will not substitute a new reasonable covenant under the guise of effecting a severance.<sup>164</sup> In *New Method Cleaners and Launderers Ltd. v. Hartley*,<sup>165</sup> the defendant, a laundry deliveryman, had agreed in his contract of employment with the plaintiff, whose business was confined to the city of Winnipeg, not to solicit any of the plaintiff’s customers within the Province of Manitoba for one year after the termination of his employment. The trial judge found that the covenant was too wide as to area but considered that the doctrine of severance permitted him to restrain the defendant from soliciting within the area in and about Winnipeg in which the defendant had worked for the plaintiff. The Court of Appeal reversed this decision. It held that a contract can be severed if the severed part is independent of the other and that what had been done by the trial judge was not a severance of the covenant

“but the substitution for it of a new covenant in which an area limited to the city of Winnipeg and neighbourhood took the place of the geographical limits of the Province”.<sup>166</sup>

This case was approved in *Gordon v. Ferguson*<sup>167</sup> by MacDonald J. A. who, speaking for the majority, said that severance depended upon

<sup>164</sup> In the American law this view is still preponderant ; but it appears that if a covenant is drafted too broadly, a growing number of courts are ready to reform it and to enforce it only to a limit which they find reasonable, even if the covenant is by its terms indivisible. See G. L. BRYENTON, *loc. cit. supra*, footnote 22, at pp. 179-180 ; Gary P. KREIDER, “Trends in the Enforcement of Restrictive Employment Contracts”, (1966) 35 *U. Cin. L.R.* 16, at pp. 24 *et seq.*

<sup>165</sup> *Supra*, footnote 48.

<sup>166</sup> *Ibid.*, at p. 715. In three previous cases, it had also been held that the courts cannot make a new covenant for the parties : *Allen Manufacturing Co. v. Murphy*, *supra*, footnote 74 (an employee of a laundry business operating in Toronto had undertaken not to engage in a similar business within the limits of the Dominion of Canada for three years — the prohibition was found too wide as to area and not severable); *George Weston Ltd. v. Baird*, *supra*, footnote 85 (at p. 737, per Lennox J. A. : “It is true that some of the restrictions may be enforced and other disregarded, if the provisions are distinctly severable [...]. But Courts are reluctant to exercise this power, and will only do so, if at all, where the valid are clearly severable from the invalid restrictions. The Court should not be asked to devise or frame an *ex post facto* contract”); *Totem Manufacturing Co. v. Le Drew*, [1924] 3 D.L.R. 340, 2 W.W.R. 640 (Alb. S.C.).

<sup>167</sup> *Supra*, footnote 66.

"very technical considerations, such as whether it constitutes one entire or indivisible covenant or a series of several and independent covenants, or whether it is in such a form as to admit the excision of a word or phrase without other alteration, and so as not to change the substance of the remainder".<sup>168</sup>

If we examine the cases in which severance has been permitted, it appears that a covenant is regarded as divisible and severable if it consists of two or more parts connected by the term "or". Everything turns upon the wording of the covenant. Thus, in *Hall v. More*,<sup>169</sup> a physician agreed in his contract of employment that, on leaving his employer, he would not for a period of five years "practise his profession in the city of Nanaimo or within the radius of twenty miles therefrom". The court found that the restriction as to the area outside Nanaimo was unreasonable but it gave effect to the restriction in respect of the city of Nanaimo because that part of the covenant was "so described in the instrument itself as to be severable". On the other hand, in *Gordon v. Ferguson*,<sup>170</sup> MacDonald J. A., who stated that *Hall v. More* was "a clear case of severance", refused to sever a covenant by a doctor not to practise medicine "within the town of Darmouth and a radius of twenty miles from the boundaries thereof" because such a covenant was :

"not merely an agglomeration of independent and several covenants, and therefore one admitting of no curtailment of the area of the prohibited activity by way of severance".<sup>171</sup>

Other cases illustrate the fact that the insertion or employment of the term "or" is of primary importance for severance. In *Garbutt Business College Ltd. v. Henderson*,<sup>172</sup> the principal of a business college undertook not to "manage or teach or be otherwise concerned of financially interested in any other business college within the city of Calgary". The covenant was held severable as to the part "be otherwise concerned or financially interested".<sup>173</sup> And in *Campbell, Imrie and Shankland v. Park*,<sup>174</sup> the undertaking by an accountant not "to carry on business as an accountant in the city of Vernon or elsewhere within a 75 mile radius thereof" was severed as to the part "or elsewhere within a 75

<sup>168</sup> *Ibid.*, at pp. 185-186 ; see also : *R. C. Young Insurance Ltd. v. Bricknell*, *supra*, footnote 109 ; *T. S. Taylor Machinery Co. Ltd. v. Biggar*, *supra*, footnote 55a.

<sup>169</sup> *Supra*, footnote 51.

<sup>170</sup> *Supra*, footnote 66.

<sup>171</sup> *Ibid.*, at p. 188.

<sup>172</sup> *Supra*, footnote 91.

<sup>173</sup> "The authorities are clear that if the restraint is more than reasonably necessary the court will not itself cut it down to what is reasonably necessary unless the excessive part has been made severable by the parties." : Per Harvey C. J. A., *ibid.*, at p. 171.

<sup>174</sup> *Supra*, footnote 51.

mile radius thereof". Severance was, however, refused in the case of *Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*<sup>175</sup> in which the seller of a business agreed not to engage "in a fur marketing organization within the : (a) City of Winnipeg, in the Province of Manitoba ; (b) City of Montreal, in the Province of Quebec ; (c) Dominion of Canada", because, said Beaubien J. A.,

"the courts will not split up a single restriction expressed in indivisible terms [...] the courts will sever in a proper case where the severance can be performed by a blue pencil but not otherwise".<sup>176</sup>

It is probable that if the areas described had been connected by the conjunction "or", the covenant would have been found divisible and severance would have been permitted. Severance would also have been permitted if it had been expressly provided in the agreement that provisions as to area constituted distinct and separate covenants.<sup>177</sup>

In the face of these authorities, it may be concluded that severance is possible when a covenant consist of two or more distinct and separate parts. There is, however, a recent decision, *E. P. Chester Ltd. v. Mastorkis*,<sup>178</sup> which seems not to be in accordance with the views expressed so far by the Canadian courts. In this case, the defendant, a sales representative, agreed, for a period of two years following the termination of his employment, not to participate in any competing business "in the Atlantic Provinces". The trial judge decided to "sever from the restrictive covenant the Province of Newfoundland because the evidence indicates the plaintiff did not do much business there" and this finding was readily affirmed by the Court of Appeal "for the extension of the restriction in the Province of Newfoundland was, according to the evidence, of trivial importance and did not affect the main purport or substance of the clause in question".<sup>179</sup>

It is submitted that the covenant in question, as framed, constituted a single and indivisible covenant and was not severable following the principles established in the previous cases.

It has been said that, in the English law, severance will be more readily allowed in the case of a restraint between vendor and purchaser than in the case of one between master and servant.<sup>180</sup> It does not seem

<sup>175</sup> *Supra*, footnote 128.

<sup>176</sup> *Ibid.*, at p. 166.

<sup>177</sup> See *Greening Industries Ltd. v. Penny*, *supra*, footnote 117.

<sup>178</sup> *Supra*, footnote 49.

<sup>179</sup> *Ibid.*, at p. 140.

<sup>180</sup> *Halsbury's Laws of England*, *supra*, footnote 162, at p. 52 ; W. R. ANSON, *supra*, footnote 34, at p. 358.

that such a distinction exists in Canadian law. In *Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*,<sup>181</sup> for instance, the court, to determine if a covenant undertaken by the seller of a business was severable, relied upon and applied the rules set forth in two cases dealing with employee covenants, those of *Atwood v. Lamont*<sup>182</sup> and *New Method Cleaners and Launderers Ltd. v. Hartley*.<sup>183</sup>

### Part III

#### Interpretation of covenants not to compete

The general rules of interpretation common to the whole law of contract are applied to restrictive covenants<sup>184</sup> and we think that there is no need to deal with them here. Our intention, under the above heading, is rather to examine how certain particular words and phrases which are continually encountered in restrictive covenants have concretely been construed and interpreted by the courts. Let us mention immediately that the meaning and the scope of an expression may be different according to the type of contract in which a covenant is included. The courts, indeed, have expressed the view that covenants making part of contracts of employment must be strictly construed while covenants incidental to transfers of businesses or other types of contract may receive a more liberal interpretation.<sup>185</sup>

#### A. Distance or area

When a distance is mentioned in a covenant not to compete, it is measured in a straight line, "as the crow flies", unless the parties have expressly adopted some other method of measurement.<sup>186</sup>

<sup>181</sup> *Supra*, footnote 128.

<sup>182</sup> [1920] 3 K.B. 571, [1920] All E.R. 55.

<sup>183</sup> *Supra*, footnote 48.

<sup>184</sup> F. A. GARE, *op. cit. supra*, footnote 6; F. R. BATT, *op. cit. supra*, footnote 1, p. 114.

<sup>185</sup> *Markson v. Rosenberg*, *supra*, footnote 116, at p. 1011, per Middleton J. A.: "I merely desire to point out that while covenants in restraint of trade in employment cases are strictly construed and the plaintiff is held to the letter of his bond, in cases in which the plaintiff is the purchaser of a business all stipulations intended to secure to him the benefit of the goodwill he has purchased are so construed as to give to him the most ample protection". See, to the same effect: *Mayer v. Lanthier*, (1930-31) 39 O.W.N. 346 (O.H.C.); *Snell v. Mittiinen*, [1931] W.W.R. 209 (Sask. C.A.); *Silverman v. Shubinski*, [1946] O.W.N. 426 (O.H.C.).

<sup>186</sup> *Mouffet v. Cole*, (1872) 8 Exch. 32; F. A. GARE, *op. cit. supra*, footnote 6, pp. 125-126.

Even if the means by which the measurement is carried out are settled, the difficulties are in no way completely exhausted ; it is also important to determine the exact point from which the measurement is to be made to know the specific territory on which the covenant may be enforced. That is why drafters of covenants should avoid using general expressions like "ten miles of the city of X" or "in the city of X and ten miles thereof", and specify a particular point from which the distance might be measured in order to eliminate uncertainties.<sup>187</sup>

**B. "Carry on", "Engage in", "Interested in",  
"Enter into competition"**

The first problem which arises in construing a covenant not to "carry on", "engage in" or "be interested in" a specified kind of business is to decide whether the covenantor is thereby prevented from taking employment in such a business. It appears from the English jurisprudence that a covenant forbidding only to "carry on" a certain kind of business is not broken by the covenantor being engaged as an employee in such a business.<sup>188</sup> The Canadian courts, so far, have not had to decide on this point. They have, however, often interpreted covenants "not to engage in" or "be interested in" a similar business, and it is clear that these expressions, either in employment or sale cases, include the case where the party subject to the restriction takes employment at a salary or wages as well as the case in which he carries on such a business on his own account or in partnership. In *Skeans v. Hampton*,<sup>189</sup> a travelling salesman selling teas and coffees had undertaken not to engage in the same business within a certain area. Meredith C. J. A., speaking for the court, stated that the promise bound the salesman "not to engage in the business within the prescribed area either on his own account or as the servant or employee of another".<sup>190</sup> In *Ryder v. Lightfoot*,<sup>191</sup> Ilesley J. also held that a covenant not to engage in a competitive field of business given by a vendor to the purchaser of a business may be enforced by the latter against the vendor even

<sup>187</sup> In *Cattle v. Thorpe*, (1900) W.N. 83, the covenant was "at Ilkeston or within ten miles thereof". Byrne J. held that the prescribed area extended to any place which was within ten miles of the borough boundary of Ilkeston.

<sup>188</sup> F. R. BART, *op. cit. supra*, footnote 1, at p. 116 ; F. A. GARE, *op. cit. supra*, footnote 6, at pp. 131 *et seq.*

<sup>189</sup> *Supra*, footnote 86.

<sup>190</sup> *Ibid.*, at p. 434.

<sup>191</sup> (1965) 51 D.L.R. (2d) 83 (N.S.S.C.). See also : *Anderson v. Ross*, (1906) 14 O.L.R. 683 (O.C.A.); *Lerik v. Zafiris*, *supra*, footnote 115 ; *Ronbar Enterprises Ltd. v. Green*, [1954] 2 All E.R. 266, 1 W.L.R. 815.

though the vendor engages in the competitive business as an employee of another.

In the case of covenants not "to enter into competition", conflicting interpretations have been given by the courts. In *Mayer v. Lanthier*,<sup>192</sup> a barber had promised not to "enter into competition" with his employer. Fisher J. A. expressed the opinion that the covenantor was not debarred from becoming an employee of "an opposition firm", but only from establishing and carrying on a business in competition with the plaintiff. In *Markson v. Rosenberg*,<sup>193</sup> however, a sale of business case, the court gave a more liberal interpretation and decided that a covenant not to enter into competition was violated by the covenantor managing a competing business under a general power of attorney as manager at a fixed salary.

We further believe that a covenant not "to engage in" or "be interested in" a certain business precludes the covenantor from aiding and abetting somebody else, financially or through publicity, to establish and organize such a kind of business. In *Parnell v. Dean*,<sup>194</sup> Armour C. J. even decided that a covenant by a former partner not to engage or be directly or indirectly interested in the business of a baker was broken by the covenantor assisting the owners of a similar business as a volunteer and without remuneration.

Difficulties may again arise when a person who has promised not to engage in or be interested in a business becomes a shareholder of a company operating this kind of business. In our opinion, a person who holds shares in a large public company, cannot be said to be engaged or interested in the business carried on by the company within the meaning of a restrictive covenant. However, it appears that the holding of shares in a small or private company would be covered by the words "engage in" or "be interested in".

Finally, let us mention that, even if two kinds of businesses somewhat overlap, the carrying on of the second business is not necessarily a breach of the covenant not to carry on or engage in the first. In *Stop & Shop Ltd. v. Independent Builders Ltd.*,<sup>195</sup> for instance, the plaintiff brought an action to restrain the defendant from leasing certain premises for the purpose of carrying on a delicatessen store on the ground that it was a breach of a covenant not to lease any portion of these premises for the purpose of carrying on a grocery or meat business. It was held

<sup>192</sup> *Supra*, footnote 185, at p. 347.

<sup>193</sup> *Supra*, footnote 116.

<sup>194</sup> (1900) 31 O.R. 517 (Q.B.D.).

<sup>195</sup> [1933] 1 D.L.R. 727 (O.S.C.).

that a covenant in restraint of trade must be strictly construed and that as the delicatessen business is substantially different and distinct from the grocery or meat business the mere fact that in the sale of these articles the defendant's trade overlapped that of the plaintiff, did not constitute a breach of the covenant in question.<sup>196</sup>

### C. At any time

We have seen that a covenant not to compete contained in a contract of sale, partnership or lease may be valid even if it is unlimited as to time.<sup>197</sup> So far, the courts have construed such a covenant as being enforceable during the lifetime of the covenantor. In *Baird v. Jones*,<sup>198</sup> the seller of a business had entered into a restrictive covenant extending from the date of the sale to the "end of time". Hazen J. considered "that the words 'to the end of time' must mean during the natural life of the seller". The same construction has also been given in English cases.<sup>199</sup>

## Part IV

### Enforcement of covenants not to compete

#### A. Assignability of a covenant

It is well settled that a covenant not to compete is freely assignable by the covenantor and is consequently enforceable by the assignee, although there is no specific agreement that the covenant is assignable.<sup>200</sup> It has even been clearly established that the benefit of a restrictive covenant passes to the purchaser of the covenantor's business even if the covenant is not specifically assigned<sup>201</sup> and that, on the covenantor's

<sup>196</sup> To the same effect : *Stuart v. Diplock*, (1890) 43 Ch. D. 343 ; *Turner v. Burns*, (1894) 24 O.R. 28 (Q.B.D.); *Falls v. Block*, [1931] 2 W.W.R. 93 (Sask. K.B.).

<sup>197</sup> *Supra*, p. 41.

<sup>198</sup> *Supra*, footnote 116, at p. 33.

<sup>199</sup> *Elves v. Crofts*, (1850) 10 C.B. 241, 138 Eng. R. 98 ; *Jacoby v. Whitmore*, (1884) 49 L.T. 335 (C.A.).

<sup>200</sup> *Berry v. Days*, (1903) 5 O.L.R. 629 (Div. C) ; *Day v. Trull*, (1929) 36 O.W.N. 262 ; *Barkett and Barkett v. Shaw*, (1960) 24 D.L.R. (2<sup>d</sup>) 234 (Man. Q.B.).

<sup>201</sup> *Jacoby v. Whitmore*, *supra*, footnote 199 ; *Townsend v. Jarman*, (1900) 2 Ch. 698 ; *Falls v. Block*, *supra*, footnote 196 ; *Newhook v. Elson*, (1960) 44 M.P.R. 258 (Nfld S.C.) ; *Fluorescent Sales and Service Ltd. v. Bastien*, (1962) 39 W.W.R. 659 (Alb. S.C., App. Div.).

death, a covenant automatically passes to his personal representatives.<sup>202</sup> In other words, a restrictive covenant runs with the goodwill of the business it is designed to protect. The foundation of this reasoning is that a vendor or employee covenant protects and adds value to the goodwill of the covenantee's business and is consequently transferred with it like any other asset.<sup>203</sup>

### B. Effect of a wrongful dismissal

If an employer wrongfully dismisses his employee, he can no longer enforce the restrictive covenant contained in the contract of employment. In *General Billposting Co. v. Atkinson*,<sup>204</sup> the appellant company had wrongfully dismissed the respondent and subsequently sought to enforce a restrictive covenant contained in the contract of employment. The House of Lords held that the dismissal constituted a repudiation by the company of the terms of the contract and that the employee, who was entitled to sue the company for breach of contract, had ceased to be bound by the restrictive covenant.<sup>205</sup> This decision was applied in *Measures Brothers, Ltd. v. Measures*,<sup>206</sup> and in the Canadian case of *Deacon v. Crehan*.<sup>207</sup>

### C. Recourses against third parties

The employer who engages a person while fully knowing that this person is bound by a restrictive covenant may be sued by the covenantee for the tort of inducing breach of contract. The simple knowledge of an existing restrictive covenant at the time of entering into the contract

<sup>202</sup> *Price v. Green*, (1847) 16 M. & W. 346 ; *Smith v. Hawthorn*, (1897) 76 L.T. 716.

<sup>203</sup> "Such an agreement since it adds value to the business and is to protect it passes on the assignment of the business"; Per Primrose J. in *Fluorescent Sales and Service Ltd. v. Bastien*, *supra*, footnote 201, at p. 662.

<sup>204</sup> [1909] A.C. 118.

<sup>205</sup> "This authoritative decision of the House of Lords has overruled previous decisions which held the employee liable to the covenant, leaving him to sue for damages for the wrongful dismissal : see *Proctor v. Sargent* (1840), 2 H. & Gr. 20" : W. A. SANDERSON, *op. cit. supra*, footnote 6, p. 83.

<sup>206</sup> [1910] 2 Ch. 248.

<sup>207</sup> [1925] 4 D.L.R. 664, 57 O.L.R. 597, 29 O.W.N. 34 (O.S.C.) : "If the employer wrongfully dismisses the employee, he cannot enforce a covenant in restraint of trade as against the employee" : per Wright J. at p. 668. In *Ryerson v. Murdock*, (1902) 1 O.W.R. 466, MacMahon J. has held that a master cannot demand the resignation of his employee on an untenable ground and, when the demand is complied with, used it as an instrument to prevent him from earning a livelihood through being employed in the business to which he is accustomed.



of employment is sufficient to support this kind of action ; no proof of malicious intention has to be made. In *Garbutt Business College v. Henderson*,<sup>208</sup> a case of employee covenant, the covenantee brought an action against both the covenantor and the company who had secured his services while knowing that he was subjected to a restrictive covenant. Damages were awarded against both the covenantor *ex contractu* and the company for wrongfully inducing a breach of the covenant. Harvey C. J. A. stated :

“[...] the company and all its officers well knew that what it was doing in employing Henderson was in breach of his agreement with the plaintiff. It is argued that it could only be liable if it wilfully induced Henderson to break his contract. I can see no sanctity in the word “induce”, nor do I think that wilfulness beyond knowledge is essential. Every day that Henderson was in the employ of the defendant company he was being aided and encouraged and paid to break his contract [...]. In my opinion the defendant company thereby committed a tort rendering itself liable for damages [...]”.<sup>209</sup>

In *Ryder v. Lighfoot*,<sup>210</sup> Ilesley J. also expressed the opinion that an employer may be liable for the tort of unlawfully procuring breach of contractual relations if he knew of the restrictive covenant imposed upon the vendor of a business whom he has engaged.

An action for the tort of inducing breach of contract may also be brought against a person who helps as partner or otherwise a vendor or an employee bound by a restrictive covenant to set up his own business in violation of the terms of the covenant.<sup>211</sup> If a covenant is void, the allegation of conspiracy to induce its breach will necessarily fail.<sup>212</sup>

#### **D. Remedies for breach of covenants**

The party entitled to enforce a restrictive covenant may in case of breach of it bring an action for damages or ask for an injunction. We shall briefly consider each of these remedies in turn.

##### **1. Action for damages**

The courts have not, in the matter of restrictive covenants, departed from the general rule that the vindictive or exemplary damages of the law of tort have no place in the law of contract except in case of breach of

<sup>208</sup> *Supra*, footnote 91.

<sup>209</sup> *Ibid.*, at p. 173 (D.L.R.). See also Ford J. A. at p. 179.

<sup>210</sup> *Supra*, footnote 128, at p. 92.

<sup>211</sup> *Lerik v. Zaferis*, *supra*, footnote 114.

<sup>212</sup> *Northern Messenger (Calgary) Limited v. Frost*, (1966) 56 W.W.R. 412, (1966) 57 D.L.R. (2<sup>d</sup>) 456, (1967) 49 C.P.R. 440.

promise of marriage.<sup>213</sup> This has been confirmed by the recent case of *Greening Industries Ltd. v. Penny*,<sup>214</sup> in which Bissett J. stated, after having referred to English authorities :

"I might well be inclined, if I could, to award the plaintiff exemplary damages but I do not think it can be done in an action for breach of a contract of this kind".

Damages are, therefore, awarded only to compensate for the economic or pecuniary loss caused to the covenantee or his successor by the covenantor's breach of a restrictive covenant. And even if these damages cannot "be precisely ascertained, nevertheless it is the duty of the courts to assess them as best it can".<sup>215</sup> Although no precise guidelines have been laid down by the courts, some cases give indications of the factors taken into consideration in the assessment of damages. In *Campbell, Imrie and Shankland v. Park*<sup>216</sup> the plaintiff firm of accountants had engaged the defendant as manager of its branch office in Vernon. After having resigned his position, the defendant opened an office in Vernon in breach of a restrictive covenant. The plaintiffs took an action for damages and for an injunction. Wilson J. held that the amount of one year's gross fees of the plaintiff's clients who had gone over to the defendant, that is to say \$6,793, was not the full measure of damages. He said :

"The Vernon office is only profitable when a sufficient volume of business is handled to care for the overhead and yield a profit. The rate of profit, as well as the quantum of profit, rises sharply as the business increases. The loss of one-third of this business is a calamitous one for the plaintiff. Taking all factors into consideration, I fix damages at \$10,000".<sup>217</sup>

In *Greening Industries Ltd. v. Penny*,<sup>218</sup> where the vendors of a business had set up a competing one in violation of a restrictive covenant, Bissett J. awarded damages for estimated loss of profits and for the reduction of the value of the goodwill of the purchased business.<sup>219</sup> When it is found that the injured party has not, in fact, suffered any pecuniary

<sup>213</sup> W. R. ANSON, *op. cit. supra*, footnote 34, p. 499.

<sup>214</sup> *Supra*, footnote 117, at p. 656.

<sup>215</sup> *Snell v. Miettien*, *supra*, footnote 185, at p. 211 ; *Lerik v. Zaferis*, *supra*, footnote 114, at p. 531.

<sup>216</sup> *Supra*, footnote 51.

<sup>217</sup> *Ibid.*, at p. 184.

<sup>218</sup> *Supra*, footnote 117.

<sup>219</sup> Cases in which damages have been awarded : *Mizon v. Pohoretzky*, *supra*, footnote 74 ; *Baird v. Jones*, *supra*, footnote 116 ; *Griffey v. Watts*, *supra*, footnote 117 ; *Snell v. Miettien*, *supra*, footnote 185 ; *Garbutt Business College Ltd. v. Henderson*, *supra*, footnote 91.

loss by reason of the breach of the covenant, nominal damages are nevertheless recoverable.<sup>220</sup>

If the parties to a restrictive covenant have fixed beforehand the amount which is to be paid by way of damages in the event of breach, the courts will follow the general principles of the law of contracts to determine if the sum stipulated constitutes "liquidated damages" and is recoverable as such by the covenantee or constitutes a "penalty" so that the covenantee is entitled to recover only for the actual loss suffered. In *Shatilla v. Feinstein*,<sup>221</sup> the sellers of a business had undertaken to pay in case of breach of a restrictive covenant, \$10,000 "to be recoverable on each [. . .] breach as liquidated damages and not as penalty". The stipulated sum was held to constitute a penalty. On the other hand, in *Cope v. Harasimo*,<sup>222</sup> a sum of \$2,500 fixed as liquidated damages in case of breach of a covenant by the seller of a business was held to be "not a penalty but a reasonable sum to award the plaintiff for damages caused by the breach".

## 2. Injunction

The usual and the most effective method of enforcing a valid covenant not to compete is the injunction. A plaintiff may claim both damages and an injunction.<sup>223</sup> If the parties to a covenant have agreed for the payment of a sum by way of liquidated damages in case of breach, the right to enforce this covenant by injunction still lies but the covenantee cannot obtain both the sum by way of liquidated damages and an injunction; he must elect between the two.<sup>224</sup> However, it has been decided in *Mills v. Gill*<sup>225</sup> that if it is expressly provided in the agreement that the recovery of the stipulated liquidated damages does not waive the right to claim an injunction, the injured party will be entitled to both the liquidated damages and an injunction. In this case,

<sup>220</sup> *Canadian Linen Company Ltd. v. Graham*, [1937] 3 W.W.R. 326, 52 B.C.R. 287 (B.C.S.C.); *Peerless Laundry & Cleaners Ltd. v. Neal*, *supra*, footnote 48.

<sup>221</sup> [1923] 3 D.L.R. 1035 (Sask. C.A.).

<sup>222</sup> *Supra*, footnote 116. Another restrictive covenant case in which the sum stipulated was regarded as "liquidated damages" is that of *Mills v. Gill*, *supra*, footnote 51.

<sup>223</sup> *Garbutt Business College Ltd. v. Henderson*, *supra*, footnote 91; *Gestetner (Canada) Ltd. v. Henderson*, *supra*, footnote 49; *Campbell, Imrie and Shankland v. Park*, *supra*, footnote 51; *Greening Industries Ltd. v. Penny*, *supra*, footnote 117.

<sup>224</sup> *Deacon v. Crehan*, *supra*, footnote 94; *Mills v. Gill*, *supra*, footnote 49; F. R. BATT, *op. cit. supra*, footnote 1, p. 121; *Halsbury's Laws of England*, *supra*, footnote 162, p. 54; N. H. MOLLER, *op. cit. supra*, footnote 6, p. 67.

<sup>225</sup> *Ibidem*.

a certain sum had been fixed as liquidated damages and it was further provided that "recovery of such liquidated damages [...] does not preclude [...] the Clinic Partners [the employer] from applying for an injunction". McLennan J. decided that the covenantee was entitled to an injunction in addition to the liquidated damages. He said :

"From an examination of the clause in question it seems quite clear that the agreement did not contemplate that the defendant, by paying liquidated damages, might carry on in breach of the covenant, but on the contrary that the parties intended that the right, if any, to an injunction should be preserved".<sup>226</sup>

### E. Enforcement of covenants included in collective agreements

It seems that covenants not to compete are very seldom inserted in collective agreements in Canada.<sup>227</sup> There is only one reported Canadian case involving the enforcement of a restrictive covenant contained in a collective agreement, that of *Nelson Laundries Ltd. v. Manning*.<sup>228</sup> In this case, the collective agreement contained a restrictive covenant which precluded driver employees of a laundry company from soliciting laundry and dry cleaning business in the areas of the employees' respective routes for six months after the termination of the employer-employee relationship for any cause. The clause commenced : "The union and each employee covenant and agree [...]". The covenant itself was found to be reasonable and enforceable. The British Columbia Supreme Court granted an interlocutory injunction until trial against a former employee who had been dismissed for cause and who was acting contrary to the covenant, on the reasoning that the terms of the covenant were incorporated at least by implication into the individual contract of employment :

"There was a contract of service between the plaintiff and the defendant. The question is what were its terms. In the absence of some evidence to indicate a contrary stipulation I must find that the terms of that contract are those terms of the collective agreement which deal with the rights and obligations which are to subsist between the employer on the one part and the employee on the other".<sup>229</sup>

<sup>226</sup> *Ibid.*, at p. 40 (D.L.R.).

<sup>227</sup> A study of the contents of collective agreements published in 1964 by the Federal Department of Labour does not mention covenants not to compete : *Clauses de conventions collectives de grands établissements manufacturiers*, Direction de l'Économique et des Recherches, ministère du Travail, Ottawa, 1964.

<sup>228</sup> (1965) 51 D.L.R. (2<sup>d</sup>) 537, 51 W.W.R. 493 (B.C.S.C.). This case is commented by A. W. R. CARROTHERS, *Collective Bargaining Law in Canada*, Toronto, Butterworths, 1966, p. 337.

<sup>229</sup> *Ibidem*, at p. 544. This conclusion seems to have been reached independently of the fact that the clause expressly purported to bind individual employees.

The effect of this judgment is that a covenant not to compete contained in a collective agreement being considered as a term of the contract of service will be enforceable by writ "unless as a matter of intent and of law the arbitration clause can be found to exclude litigation or to be a condition precedent to it".<sup>230</sup>

Let us add that if a collective agreement, which does not contain a restrictive covenant, provides for the discharge of an employee only for just cause, it derives from the case of *K. M. A. Carterers Ltd. v. Howie*<sup>230a</sup> that the giving or continuance of employment is not consideration for a covenant not to compete inserted in an individual contract of service between the employer and an employee. This decision will probably prompt employers to include covenants not to compete in the collective agreement itself.

#### F. Conflict of laws problems

It is a general rule of the conflict of laws that the validity of a contract is governed by the "proper law of the contract", i.e. the law by which the parties intended, or may fairly be presumed to have intended, the contract to be governed.<sup>231</sup> There is, however, one exception to that rule : the courts of a country will not apply a foreign law if its application would lead to results contrary to the fundamental principles of public policy of the *lex fori*.<sup>232</sup> Pursuant to this principle, Fry J. stated, in *Rousillon v. Rousillon*,<sup>233</sup> that if a covenant in restraint of trade is void as against the public policy of England, it will not be enforced by English courts, though made in a country where no objection could be raised to it :

"It has been insisted that, even if the contract was void by the law of England as against public policy, yet, in as much as the contract was made in France, it must be good here because the law of France knows no such principle as that by which unreasonable contracts in restraint of trade are held to be void in this country". It appears to me, however, plain on general principles that this court will not enforce a contract against the public policy of this country, wherever it may be made. It seems to me almost absurd to suppose that the courts of this country should enforce a contract which they consider to be against public policy, simply because it happens to have been made somewhere else".

<sup>230</sup> A. W. R. CARROTHERS. *op. cit. supra*, footnote 228, p. 338.

<sup>230a</sup> *Supra*, footnote 87a.

<sup>230b</sup> For a summary of the decision, see *supra*, p. 273.

<sup>231</sup> DICEY & MORRIS, *The Conflict of Laws*, 8<sup>th</sup> ed., London, Stevens & Sons Ltd., 1967, pp. 691 *et seq.*

<sup>232</sup> DICEY & MORRIS, *ibid.*, at p. 726.

<sup>233</sup> (1880) 14 Ch. D. 351, at p. 369.

There is no case on this point in Canada. We believe that Canadian courts ought also to refuse to enforce a restrictive covenant which would be unreasonable and void by the *lex fori* as against public policy, although such a covenant would be valid by its foreign "proper law".

### Conclusion

Courts no longer manifest an outright hostility to restrictive covenants, as they did in the early common law. They yet see these kinds of agreements with suspicion and scrutinize them quite severely. They consider that the freedom of a man to carry on his lawful trade or profession is a basic social value and consequently, on the ground of public policy, they do not hesitate to interfere with contractual relations each time they believe that a man has deprived himself of this freedom without necessity and beyond reasonable limits. The freedom of a man to contract is therefore submitted to a strict control. This equitable approach taken by the courts introduces uncertainties into the law and renders the drafting of a restrictive covenant very difficult. It must be done with great care and moderation, while remembering that the greater is the protection given to the covenantee, the greater is the risk that the covenant be struck down as unreasonable and against public policy.

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## TABLE OF CASES

	Footnotes
<i>Allen Manufacturing Co. v. Murphy</i> , (1911) 23 O.L.R. 467, 18 O.W.R. 572, 2, O.W.N. 877 (O.C.A.)	74, 102, 166
<i>American Building Maintenance Co. Ltd. v. Shandley</i> , (1966) 58 D.L.R. (2 <sup>d</sup> ) 525, 57 W.W.R. 133 (B.C.C.A.)	41, 45, 58, 145
<i>Anderson v. Ross</i> , (1906) 14 O.L.R. 683 (O.C.A.)	191
<i>Attwood v. Lamont</i> , [1920] 3 K.B. 571	80
<i>Baird v. Jones</i> , (1919-20) 47 N.B.R. 31 (Ch. D)	116, 131
<i>Barkett and Barkett v. Shaw</i> , (1960) 24 D.L.R. (2 <sup>d</sup> ) 234 (Man. Q.B.)	200
<i>Berry v. Days</i> , (1903) 5 O.L.R. 629 (O.C.A.)	200
<i>British Reinforced Concrete Engineering Co. Ltd. v. Schelff</i> , [1921] 2 Ch. 563	34
<i>Campbell, Imrie and Shankland v. Park</i> , [1954] 2 D.L.R. 170, (1953) 21 C.P.R. 1 (B.C.S.C.)	51, 67, 95, 174, 216
<i>Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely</i> , [1954] 2 D.L.R. 154, 62 Man. R. 148, [1954] W.W.R. 254 (Man. C.A.)	128, 132, 146, 175

	Footnotes
<i>Canadian Linen Company Ltd. v. Graham</i> , [1937] 3 W.W.R. 326, 52 B.C.R. 287 (B.C.S.C.)	141
<i>Carruthers Clinic Ltd. v. Herdman</i> , (1956) 5 D.L.R. (2 <sup>d</sup> ) 492, 1956 O.R. 770	108
<i>City Dray Co. Ltd. v. Scott</i> , [1950] 4 D.L.R. 657, 2 W.W.R. 913 (Man. K.B.)	41, 55a
<i>Colonial Broadcasting System Ltd. v. Russell</i> , (1965) 48 D.L.R. (2 <sup>d</sup> ) 242 (Nfld S.C.)	41, 146
<i>Connors Bros. Ltd. v. Connors</i> , [1941] 1 D.L.R. 81, 3 W.W.R. 666 (P.C., N.B.)	115, 119, 144, 148
<i>Cope v. Harasimo</i> , (1965) 48 D.L.R. (2 <sup>d</sup> ) 744, 50 W.W.R. 639, (1966) 47 C.P.R. 36 (B.C.C.A.)	116, 126, 137
<i>Day v. Trull</i> , (1929) 36 O.W.N. 262 (O.S.C.)	200
<i>Deacon v. Crehan</i> , [1925] 4 D.L.R. 664, 57 O.L.R. 597, 29 O.W.N. 34 (O.S.C.)	94, 98, 207, 224
<i>Dominion Art Co. Limited v. Murphy</i> , (1923) 54 O.L.R. 332 (O.S.C., App. Div.)	104
<i>E. P. Chester Ltd. v. Mastorkis</i> , (1968) 70 D.L.R. (2 <sup>d</sup> ) 133 (N.S.C.A.)	49, 93, 145, 178
<i>Falls v. Bloch</i> , [1931] 2 W.W.R. 93 (Sask. K.B.)	196

	Footnotes
<i>Fisher v. Rosenberg</i> , (1960) 67 Man. R. 336 (Man. Q's B.) 39, 44	
<i>Fitch v. Dewes</i> , [1921] 2 A.C. 158 .....	81, 96
<i>Fluorescent Sales and Service Ltd. v. Bastien</i> , (1962) 39 W.W.R. 659 (Alta. S.C., App. D.) .....	125, 201, 203
<i>Furlong v. Burns &amp; Co. Ltd.</i> , (1964) 43 D.L.R. (2 <sup>d</sup> ) 689, [1964] 2 O.R. 3 .....	40, 44, 74, 87, 138
<i>Garbutt Business College Ltd. v. Henderson</i> , [1939] 4 D.L.R. 151, 3 W.W.R. 257 (Alta. S.C., App. Div.) .....	91, 172, 208, 223
<i>General Billposting Co. v. Atkin- son</i> , [1909] A.C. 118 .....	204
<i>George Weston Ltd. v. Baird</i> , (1916) 31 D.L.R. 730, 37 O.L.R. 514 (O.C.A.) .....	85, 105, 110, 166
<i>Gestetner (Canada) Ltd. v. Hen- derson</i> , [1948] 3 D.L.R. 64, 2 W.W.R. 84 (Alb. S.C., App. D.) .....	49, 87, 92, 223
<i>Giannone (Re) and Stampeder Motor Hotel Ltd.</i> , (1964) 41 D.L.R. (2 <sup>d</sup> ) 242 (Alb. S.C.) .....	127
<i>Gibson v. Campbell</i> , (1921-22) 49 N.B.R. 185 (Ch. D.) .....	107
<i>Gilford Motor Co. v. Horne</i> , [1933] Ch. 935 .....	46
<i>Gordon v. Ferguson</i> , (1961) 46 M.P.R. 177, 30 D.L.R. (2 <sup>d</sup> ) 420, 38 C.P.R. 1 (N.S.C.A.), affd (1962) 46 M.P.R. 344, 40 C.P.R. 43 (C.S.C.) .....	66, 100, 145, 148, 163, 167
<i>Greening Industries Ltd. v. Pen- ny</i> , (1966) 53 D.L.R. (2 <sup>d</sup> ) 643 (N.S.S.C.) .....	117, 124, 132, 214
<i>Griffey v. Watts</i> , (1924) 25 O.W.N. 157 .....	117
<i>Hall v. More</i> , [1928] 1 D.L.R. 1028, 1 W.W.R. 400, 39 B.C.R. 346 (B.C.C.A.) .....	51, 169
<i>Harvison v. Cornell</i> , (1906) 8 O.W.R. 697 .....	102
<i>Hebert Morris, Ltd. v. Sawelby</i> , [1916] A.C. 688 .....	5, 29, 35, 43, 62, 76, 136
<i>Houghton v. Evans</i> , [1925] 3 D.L.R. 109, 25 B.C.R. 35, 2 W.W.R. 248 (B.C.S.C.) .....	114, 123

	Footnotes
<i>International Tools Ltd. v. Kol- lar</i> , (1966) 56 D.L.R. (2 <sup>d</sup> ) 289, 2 O.R. 201, [1967] C.P.R. 145 (O.H.C.) .....	42
<i>K. M. A. Caterers v. Howie</i> , (1969) 1 D.L.R. (3 <sup>d</sup> ) 558 (O.C.A.) .....	87a, 230a
<i>Kelly v. McLaughlin</i> , [1911] 1 W.W.R. 309, 19 W.L.R. 633, 21 Man R. 789 (Man. C.A.) .....	132
<i>Labone v. Litherland Urban Dis- trict Council</i> , [1956] 2 All E.R. 215 .....	155
<i>Latimer v. Fontaine</i> , [1905] 2 W.L.R. 191 .....	130
<i>Lerik v. Zaferis</i> , (1928-29) 41 B.C.L.R. 526 (B.C.C.A.) .....	114, 125
<i>Lock v. Nelson &amp; Harvey Ltd.</i> , (1960) 22 D.L.R. (2 <sup>d</sup> ) 298, 33 C.P.R. 138 (B.C.S.C.) .....	50, 91
<i>Maguire v. Northland Drug Co. Ltd.</i> , [1935] S.C.R. 412 .....	32, 38, 52, 67, 74, 87, 145
<i>Markson v. Rosenberg</i> , [1928] 1 D.L.R. 1009, 61 O.L.R. 558, (O.C.A.) .....	116, 125, 185
<i>M &amp; S. Drapers v. Reynolds</i> , [1957] 1 W.L.R. 9 .....	59, 78
<i>Mason v. Provident Clothing and Supply Co. Ltd.</i> , [1913] A.C. 724 .....	24, 72, 148, 151
<i>Mayer v. Lanthier</i> , (1930-31) 39 O.W.N. 346 (O.H.C.) .....	81, 192
<i>McAllister v. Cardinal</i> , (1965) 47 D.L.R. (2 <sup>d</sup> ) 313, 1 O.R. 221, 47 C.P.R. 28 (O.H.C.) .....	129, 145
<i>Mills v. Gill</i> , [1952] O.R. 257, 3 D.L.R. 27, 16 C.P.R. 46 (O.H.C.) .....	51, 95, 99, 108, 111, 139, 225
<i>Mitchell v. Reynolds</i> , (1711) 1 P. Wms. 181, 24 Eng. R. 347 .....	15, 68,
<i>Mizon v. Pohoretzky</i> , (1918) 38 D.L.R. 214, (1917) 40 O.L.R. 239 (O.C.A.) .....	74, 116, 125
<i>Moorman v. Schemmer and Dal- ton</i> , (1960) 21 D.L.R. (2 <sup>d</sup> ) 470 (O.H.C.) .....	155
<i>Mossop v. Mason</i> , (1871) 18 Gr. 453 (C.A.) .....	22
<i>Nelsons Laundries Ltd. v. Man- ning</i> , (1965) 51 D.L.R. (2 <sup>d</sup> ) 537, 51 W.W.R. 493 (B.C.S.C.) .....	48, 88, 228



Footnotes	Footnotes
<i>Newhook v. Elson</i> , (1960) 44 M.P.R. 258 (Nfld S.C.) ..... 118	<i>Ryerson v. Murdock</i> , (1902) 1 O.W.R. 466 ..... 207
<i>New Method Cleaners &amp; Launderers Ltd. v. Hartley</i> , [1939] 1 D.L.R. 711, 1 W.W.R. 142, (Man. Q's B.) ..... 61, 146 102, 165	<i>Silverman v. Shubinsky</i> , [1946] O.W.N. 426 (O.H.C.) ..... 185
<i>Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.</i> , [1894] A.C. 535 ..... 20	<i>Skeans v. Hampton</i> , (1914) 31 O.L.R. 424, 6 O.W.N. 463 (O.C.A.) ..... 86, 103, 189
<i>Northern Messenger and Transfer Ltd. v. Fabro</i> , (1964) 49 W.W.R. 115, 45 D.L.R. (2 <sup>d</sup> ) 73 (Man. Q's B.) ..... 61, 146	<i>Skeans v. Keegan</i> , (1916) 10 O.W.N. 225 (O.H.C.) ..... 48, 104
<i>Northern Messenger (Calgary) Ltd. v. Frost</i> , (1966) 56 W.W.R. 412, 57 D.L.R. (2 <sup>d</sup> ) 456, 49 C.P.R. 140 (Alb. S.C.) ..... 212	<i>Snell v. Miettinen</i> , [1931] 2 W.W.R. 209 (Sask. C.A.) ..... 185
<i>P.C.O. Services Ltd. v. Rumleski</i> , (1963) 38 D.L.R. (2 <sup>d</sup> ) 390, 2 O.R. 62 (O.H.C.) ..... 49, 93, 104	<i>Sotiroff v. Dimitroff</i> , [1933] O.W.N. 249 (O.H.C.) ..... 70, 114
<i>Pfcerless Laundry &amp; Cleaners Ltd. v. Neal</i> , [1953] 2 D.L.R. 494, 8 W.W.R. 309 (Man. C.A.) ..... 48, 87, 89, 104	<i>Stop and Shop Ltd. v. Independent Builders Ltd.</i> , [1933] O.R. 150, 1 D.L.R. 727 (O.S.C.) 155, 195
<i>Read and Read v. Wright</i> , (1963- 64) 45 W.W.R. 108 (B.C.S.C.) .. 2	<i>T. S. Taylor Machinery Co. Ltd. v. Biggar</i> , (1969) 2 D.L.R. (3 <sup>d</sup> ) 281 (Man. C.A.) ..... 55a, 74, 113, 168
<i>R. C. Young Insurance Ltd. v. Bricknell</i> , [1955] 5 D.L.R. 487, [1955] O.W.N. 688, 23 C.P.R. 73 (O.C.A.) ..... 109	<i>Tasco Telephone Answering Exchange Ltd. v. Ellerbeck</i> , (1966) 57 D.L.R. (2 <sup>d</sup> ) 500, 55 W.W.R. 656, (1967) 48 C.P.R. 160 (B.C.S.C.) ..... 1
<i>Ronbar Enterprises Ltd. v. Green</i> , [1954] 2 All E.R. 266, 1 W.L.R. 815 (Eng. C.A.) .. 70, 132	<i>Taylor v. McQuilkin</i> , (1969) 2 D.L.R. (3 <sup>d</sup> ) 463 (Man. Q's B.) 87
<i>Rousillon v. Rousillon</i> , (1880) 14 Ch. D. 351 ..... 19, 233	<i>Totem Manufacturing Co. v. Le Drew</i> , [1924] 3 D.L.R. 340, 2 W.W.R. 640 (Alb. S.C.) .... 90, 166
<i>Routh v. Jones</i> , [1947] 1 All E.R. 758 (Eng. C.A.) ..... 47, 108	<i>Towsend v. Jarman</i> , [1900] 2 Ch. 698 ..... 28
<i>Ryder v. Lightfoot and Burns</i> , (1965) 51 D.L.R. (2 <sup>d</sup> ) 83 (N.S.S.C.) ..... 128, 191, 210	<i>Trego v. Hunt</i> , [1896] A.C. 7 ..... 2
	<i>Vancouver Malt and Sake Brewing Co. Ltd. v. Vancouver Breweries Ltd.</i> , [1934] A.C. 181, [1934] All E.R. 38 ..... 33
	<i>Wicher v. Darling</i> , (1885) 9 O.R. 311 ..... 19, 22
	<i>William Shannon Co. v. Crane</i> , (1915) 25 D.L.R. 843 (O.S.C.) .. 108