See paras. 15-18, 26-28

** Preliminary Version **

Case Name:

Shafron v. KRG Insurance Brokers (Western) Inc.

Morley Shafron, Appellant;
v.
KRG Insurance Brokers (Western) Inc., Respondent.

[2009] S.C.J. No. 6

2009 SCC 6

[2009] 1 S.C.R. 157

[2009] 1 R.C.S. 157

52 B.L.R. (4th) 165

[2009] 3 W.W.R. 577

301 D.L.R. (4th) 522

87 B.C.L.R. (4th) 1

68 C.C.L.I. (4th) 161

70 C.C.E.L. (3d) 157

265 B.C.A.C. 1

2009 CarswellBC 79

EYB 2009-153214

J.E. 2009-241

[2009] CLLC para. 210-010

383 N.R. 217

173 A.C.W.S. (3d) 151

File No.: 31981.

Supreme Court of Canada

Heard: October 16, 2008;
Judgment: January 23, 2009.

Present: McLachlin C.J. and Binnie, LeBel, Deschamps, Abella, Charron and Rothstein JJ.

(59 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Employment law -- Contract of employment -- Express terms -- Restrictive covenants -- Reasonability -- Appeal by a former employee from Court of Appeal judgment, which set aside a decision whereby the trial judge refused to enforce a restrictive covenant -- Appeal allowed -- Appellant left respondent employer to work for a competitor in Richmond -- The term "Metropolitan City of Vancouver" in the restrictive covenant was uncertain and ambiguous -- An ambiguous restrictive covenant was prima facie unenforceable because the party seeking enforcement was unable to demonstrate reasonableness in the face of an ambiguity -- The Court of Appeal erred in rewriting the geographic scope in the restrictive covenant to what it thought was reasonable.

Appeal by Shafron from a decision of the Court of Appeal of British Columbia, which overturned a decision whereby the trial judge refused to enforce a restrictive covenant. Shafron was employed by KRG Insurance Brokers (Western) Inc. as an insurance salesman. He left KRG in 2001 to work for a competitor in Richmond. KRG commenced an action to enforce the restrictive covenant signed by Shafron and further claimed that he had breached fiduciary and equitable obligations. The trial judge found that the restrictive covenant was neither clear, certain nor reasonable because it used the term "Metropolitan City of Vancouver". The Court of Appeal held that the restrictive covenant was enforceable, even though the term "Metropolitan City of Vancouver" was ambiguous. The Court of Appeal applied the doctrine of notional severance to construe it as applying to the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby.

HELD: Appeal allowed. The term "Metropolitan City of Vancouver" was uncertain and ambiguous. The findings of the trial judge with respect to fiduciary obligations and the improper use of

confidential information were based on evidence at trial. These were not pure questions of law and the Court of Appeal correctly did not interfere with the trial judge's conclusions on these issues. For a determination of reasonableness to be made, the terms of the restrictive covenant had to be unambiguous. An ambiguous restrictive covenant was be prima facie unenforceable because the party seeking enforcement was unable to demonstrate reasonableness in the face of an ambiguity. Notional severance, which involved reading down a contractual provision so as to make it legal and enforceable, had no place in the construction of restrictive covenants in employment contracts. There was no evidence that the parties unquestioningly would have agreed to remove the word "Metropolitan" without varying any other terms of the contract or otherwise changing the bargain. Further, there was no indication that the parties agreed on something and then mistakenly included something else in the written contract and rectification could not be invoked to resolve the ambiguity in this case. The Court of Appeal erred when it rewrote the restrictive covenant in this case to substitute the term "City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby" for the term "Metropolitan City of Vancouver". It was inappropriate for the Court of Appeal to rewrite the geographic scope in the restrictive covenant to what it thought was reasonable.

Subsequent History:

NOTE: This document is subject to editorial revision before its reproduction in final form in the Canada Supreme Court Reports.

Court Catchwords:

Contracts -- Employment contracts -- Restrictive convenants -- Geographic scope of restrictive covenant ambiguous -- Whether notional severance or rectification may be invoked to resolve ambiguity or to render unreasonable restriction reasonable.

Employment law -- Fiduciary and equitable obligations -- Employee leaving his employment in insurance agency to work for another agency as insurance salesman -- Former employer alleging that employee breached fidiciary duty not to use confidential information and solicit its clients -- Whether employee owed former employer fiduciary and equitable obligations.

Court Summary:

In 1987, S sold his insurance agency to KRG. KRG renamed the agency KRG Western and in 1991, sold the agency to another party. S was employed by KRG Western from 1987 to 2001 pursuant to a series of employment contracts. Each employment contract contained a similarly worded restrictive covenant in which S agreed that for three years after leaving his employment for any reason other than termination without cause, he will not be employed in the business of insurance brokerage within the "Metropolitan City of Vancouver". In January 2001, S began working as an insurance salesman for another agency in Richmond, B.C. KRG Western commenced an action to enforce the restrictive covenant. It also claimed that S had breached fiduciary and equitable obligations. The

trial judge dismissed the action, finding that the term "Metropolitan City of Vancouver" in the restrictive convenant is neither clear, certain nor reasonable. He also found that S owed no fiduciary duty to KRG Western. The Court of Appeal set aside the decision. While the court found that there was no fiduciary duty, it held that the restrictive convenant was enforceable. The court agreed that the term "Metropolitan City of Vancouver" is ambiguous; however, it applied the doctrine of notional severance and held that the term means the "City of Vancouver, the University of British Columbia endowment lands, Richmond and Burnaby".

Held: The appeal should be allowed.

The Court of Appeal erred when it substituted the phrase "City of Vancouver, the University of British Columbia endowment lands, Richmond and Burnaby" for the "Metropolitan City of Vancouver". The term "Metropolitan City of Vancouver" was uncertain and ambiguous. Nothing demonstrates a mutual understanding of the parties at the time they entered into the contract as to what geographic area the restrictive covenant covered and it was inappropriate for the Court of Appeal to re-write the covenant. In this case, neither blue-pencil severance nor rectification can be applied to re-write the restrictive covenant. Notional severance cannot be applied to a restrictive covenant. Also, the findings that S was not a fiduciary and did not abuse confidential information belonging to KRG Western are not pure questions of law. These findings were based on evidence at trial and must stand in the absence of any palpable and overriding error by the trial judge. [para. 13] [para. 58]

Restrictive covenants generally are restraints of trade and contrary to public policy. Freedom to contract, however, requires an exception for reasonable restrictive covenants. Normally, the reasonableness of a covenant will be determined by its geographic and temporal scope as well as the extent of the activity sought to be prohibited. Reasonableness cannot be determined if a covenant is ambiguous in the sense that what is prohibited is not clear as to activity, time, or geography. An ambiguous restrictive covenant is by definition, *prima facie* unreasonable and unenforceable. The onus is on the party seeking to enforce the restrictive covenant to show that it is reasonable and a party seeking to enforce an ambiguous covenant will be unable to demonstrate reasonableness. Restrictive covenants in employment contracts are scrutinized more rigorously than restrictive covenants in a sale of a business because there is often an imbalance in power between employees and employers and because a sale of a business often involves a payment for goodwill whereas no similar payment is made to an employee leaving his or her employment. In this case, the restrictive covenant arises in an employment contract and attracts the higher standard of scrutiny. [paras. 15-17] [paras. 22-23] [paras. 25-27] [para. 43]

Notional severance, reading down a contractual provision so as to make it legal and enforceable, is not an appropriate mechanism to cure a defective restrictive covenant. Notional severance may be available where an objective bright line test exists to distinguish what is legal from what is not. There is no objective bright-line test for reasonableness and applying notional severance simply amounts to a court rewriting a covenant in a manner that it subjectively considers reasonable.

Employers should not be invited to draft overly broad restrictive covenants with the prospect that the court will sever the unreasonable parts or read down the covenant to what the courts consider reasonable. This would change the risks assumed by the parties and inappropriately increase the risk that an employee will be forced to abide by an unreasonable covenant. The Court of Appeal should not have attempted to resolve the ambiguity in this case by reading down the restrictive covenant according to its own notion of reasonableness and what it thought that the parties might have intended. [para. 2] [para. 33] [para. 39] [para. 41] [para. 47]

Blue-pencil severance, removing part of a contractual provision, may be resorted to sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purport of the restrictive covenant. Blue-pencil severance cannot be applied to remove the word "Metropolitan" from the restrictive covenant in this case because it is not merely a trivial part of the covenant agreed to by the parties. There is no evidence that the parties unquestioningly would have agreed to remove the word "Metropolitan" without varying any other terms of the contract or otherwise changing the bargain. [para. 2] [para. 36] [para. 50]

Rectification cannot be invoked to resolve the ambiguity in this case. Rectification is used to restore what the parties' agreement actually was, were it not for the error in the written agreement. Here, there is no indication that the parties agreed on something and then mistakenly included something else in the written contract. Rather, they used an ambiguous term in the contract. KRG Western can point to no prior agreement, written or oral, that explains the term "Metropolitan City of Vancouver". [para. 3] [para. 57]

Cases Cited

Explained: *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7, [2004] 1 S.C.R. 249; **applied:** *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, 2002 SCC 19, [2002] 1 S.C.R. 678; **not followed:** *T.S. Taylor Machinery Co. v. Biggar* (1968), 2 D.L.R. (3d) 281); *Putsman v. Taylor*, [1927] 1 K.B. 637; *T. Lucas & Co. v. Mitchell*, [1974] Ch. 129; **referred to:** *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.*, [1894] A.C. 535; *Herbert Morris Ltd. v. Saxelby*, [1916] 1 A.C. 688; *Leather Cloth Co. v. Lorsont* (1869), L.R. 9 Eq. 345; *J. G. Collins Insurance Agencies Ltd. v. Elsley*, [1978] 2 S.C.R. 916; *Burgess v. Indust. Frictions & Supply Co.* (1987), 12 B.C.L.R. (2d) 85; *Globex Foreign Exchange Corp. v. Kelcher*, 2005 ABCA 419; *Mason v. Provident Clothing and Supply Co.*, [1913] A.C. 724; *Attwood v. Lamont*, [1920] 3 K.B. 571; *Canadian American Financial Corp. v. King* (1989), 60 D.L.R. (4th) 293; *Frederick E. Rose (London) Ld. v. William H. Pim Jnr. & Co.*, [1953] 2 Q.B. 450.

History and Disposition:

APPEAL from a judgment of the British Columbia Court of Appeal (Huddart, Thackray and Chiasson JJ.A.), 2007 BCCA 79, 236 B.C.A.C. 116, 390 W.A.C. 116, 64 B.C.L.R. (4th) 125, 25 B.L.R. (4th) 193, 45 C.C.L.I. (4th) 163, [2007] B.C.J. No. 261 (QL), 2007 CarswellBC 276, reversing a decision of Parrett J., 2005 BCSC 1611, 12 B.L.R. (4th) 90, 30 C.C.L.I. (4th) 187,

[2005] B.C.J. No. 2506 (QL), 2005 CarswellBC 2758. Appeal allowed.

Counsel:

Neo J. Tuytel and *Valerie S. Dixon*, for the appellant.

Frank G. Potts and *Timothy J. Delaney*, for the respondent.

The judgment of the Court was delivered by

ROTHSTEIN J.:--

I. Introduction

1 The central issue in this appeal is whether, in an employment contract, the doctrine of severance may be invoked to resolve an ambiguous term in a restrictive covenant or render an unreasonable restriction in the covenant reasonable. The issue arises because the term "Metropolitan City of Vancouver" in the restrictive covenant contained in the contract between the parties has no legally defined meaning and is therefore ambiguous.

2 Severance, when permitted, appears to take two forms. "Notional" severance involves reading down a contractual provision so as to make it legal and enforceable. "Blue-pencil" severance consists of removing part of a contractual provision. For reasons I set out below, notional severance is not an appropriate mechanism to cure a defective restrictive covenant. As for blue-pencil severance, it may only be resorted to in rare cases where the part being removed is trivial, and not part of the main purport of the restrictive covenant. These circumstances are not present in this case and hence the ambiguity cannot be cured by severing the word "Metropolitan".

3 A secondary issue is whether rectification may be invoked to resolve the ambiguity. In my opinion, it cannot. There is no indication that the parties agreed on something and then mistakenly included something else in the written contract. The doctrine of rectification cannot be invoked to rewrite the bargain between the parties.

II. Facts

4 On December 31, 1987, Morley Shafron sold the shares he owned in his own insurance agency business, Morley Shafron Agencies Ltd. ("MSA"), to KRG Insurance Brokers Inc. for a total

consideration of $700,000. The name of his business was changed from MSA to KRG Insurance Brokers (Western) Inc. ("KRG Western") following the sale. Shafron continued to be employed in the business.

5 While there were a number of agreements between various parties over a period of some 12 years, it is not necessary to refer to all of them. I refer only to those relevant to the issues in this appeal. In early 1988, Shafron entered into a contract containing a non-competition clause with KRG Insurance Brokers Inc. and KRG Management Inc. (the owner of KRG Insurance Brokers Inc.). That contract contained the following terms, among others:

> Employment of Shafron
>
> 3. The Corporation [KRG Management Inc.] agrees that it shall cause KRG Insurance [KRG Insurance Brokers Inc.] or MSA to engage and to continue to engage Shafron for the term of this agreement [until January 1, 1991] to provide to the Corporation in the Province of British Columbia such managerial and insurance brokerage services as may be required or reasonably requested by KRG Insurance including, but without limiting the generality of the foregoing;
>
> ...
>
> Non-Competition
>
> 12. Shafron agrees that, upon his leaving the employment of MSA or KRG Insurance for any reason save and except for termination by KRG Insurance without cause, he shall not for a period of three (3) years thereafter, directly or indirectly, carry on, be employed in, or be interested in or permit his name to be used in connection with the business of insurance brokerage which is carried on within the metropolitan City of Vancouver. [Emphasis added.]

6 On February 28, 1991, Shafron entered into a further employment contract with KRG Western, the respondent, which was to expire on January 1, 1994, containing a non-competition clause in substantially the same form as in the 1988 agreement. This covenant provided:

> 13. Non-Competition
>
> Shafron shall not, upon his leaving the employment of the Corporation [KRG Western] for any reason, save and except for termination by the Corporation or KRG Management without cause, for a period of three (3) years thereafter, directly or indirectly, carry on, be employed in, or be interested in or

> permit his name to be used in connection with the business of insurance brokerage which is carried on within the Metropolitan City of Vancouver. [Emphasis added.]

7 On July 31, 1991, Intercity Investment Corporation ("Intercity") acquired the shares of KRG Western. The February 28, 1991 employment contract provided that upon the sale of 50 percent or more of the shares of KRG Western, Shafron's employment would terminate. In order to continue working for KRG Western, on August 1, 1991, Shafron entered into yet another employment contract with KRG Western, which was to expire on January 1, 1994, containing a restrictive covenant essentially identical to the language of the February 28, 1991 covenant. The only difference was the deletion of the words "or KRG Management" from the covenant. There were two additional renewals of this employment agreement in 1993 and 1998. The 1993 agreement expired on December 31, 1998 and the 1998 agreement expired on December 31, 2000. Each renewal included the same restrictive covenant as contained in the August 1, 1991 agreement.

8 In December 2000, as the 1998 employment contract was about to expire, Shafron left KRG Western's employment and in January 2001 began working as an insurance salesman for another agency, Shaw Insurance Agency Ltd. ("Shaw"), in Richmond.

9 KRG Western commenced an action in the Supreme Court of British Columbia claiming that Shafron was wrongly competing with it in breach of the restrictive covenant. It also made additional claims, one of which was that when he began working for Shaw, Shafron breached the fiduciary and equitable obligations he owed to KRG Western not to use confidential information and solicit KRG Western's clients.

10 The trial judge, Parrett J., dismissed KRG Western's action (2005 BCSC 1611, 12 B.L.R. (4th) 90). He found, among other things, that the term "Metropolitan City of Vancouver" was neither clear nor certain and, in any event, was unreasonable. He also found that Shafron owed no fiduciary duty to KRG Western and that he had not breached any duty relating to confidential information.

11 The British Columbia Court of Appeal reversed the decision of the trial judge (2007 BCCA 79, 236 B.C.A.C. 116). While that court found Shafron owed no fiduciary duty to KRG Western, it held that the restrictive covenant was enforceable. In the view of the Court of Appeal, while the term "Metropolitan City of Vancouver" was ambiguous, it was possible to apply the doctrine of "notional" severance to construe it as applying to the City of Vancouver and municipalities contiguous to it. According to the Court of Appeal, the covenant would cover the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby.

12 Having regard to this spatial area and the non-competition term of three years, the Court of Appeal found the covenant reasonable and therefore enforceable.

III. Issues

13 The issues before this Court are:

(1) whether the doctrine of severance or rectification may be applied to resolve an ambiguity in a restrictive covenant in an employment contract or render an unreasonable restriction in a covenant reasonable;
(2) whether Shafron owed fiduciary and equitable obligations to KRG Western and, if so, whether they were breached.

The second issue may be disposed of quickly. The findings of the trial judge with respect to fiduciary obligations and the improper use of confidential information were based on evidence at trial. These are not pure questions of law. The Court of Appeal correctly did not interfere with the trial judge's conclusions on these issues. In the absence of palpable and overriding error by the trial judge, which KRG Western did not plead or demonstrate, the trial judge's conclusions -- that Shafron was not a fiduciary and that he did not abuse confidential information belonging to KRG Western -- must stand.

IV. Analysis

14 Before dealing with the doctrine of severance, I will summarize the law on restrictive covenants.

A. *Reconciling Freedom of Contract and Public Policy Considerations Against Restraint of Trade*

15 A restrictive covenant in a contract is what the common law refers to as a restraint of trade. Restrictive covenants are frequently found in agreements for the purchase and sale of a business and in employment contracts. A restrictive covenant precludes the vendor in the sale of a business from competing with the purchaser and, in an employment contract, the restrictive covenant precludes the employee, upon leaving employment, from competing with the former employer.

16 Restrictive covenants give rise to a tension in the common law between the concept of freedom to contract and public policy considerations against restraint of trade. In the seminal decision of the House of Lords in *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.*, [1894] A.C. 535, this tension was explained. At common law, restraints of trade are contrary to public policy because they interfere with individual liberty of action and because the exercise of trade should be encouraged and should be free. Lord Macnaghten stated, at p. 565:

> The public have 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.

17 However, recognition of the freedom of the parties to contract requires that there be

exceptions to the general rule against restraints of trade. The exception is where the restraint of trade is found to be reasonable. At p. 565, Lord Macnaghten continued:

> But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable -- reasonable, that is, in reference to 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. [Emphasis added.]

Therefore, despite the presumption that restrictive covenants are *prima facie* unenforceable, a reasonable restrictive covenant will be upheld.

18 It is important at this juncture to differentiate between a contract for the sale of a business and an employment contract.

19 In *Nordenfelt*, Lord Macnaghten pointed out that there is greater freedom to contract between buyer and seller than between employer and employee. At p. 566, he wrote:

> 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. A man is bound an apprentice because he wishes to learn a trade and to practise it. A man may sell because he is getting too old for the strain and worry of business, or because he wishes for some other reason to retire from business altogether. Then 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. [Emphasis added.]

Although the comments of Lord Macnaghten focus on apprenticeship, the same concept has been extended and applied to contracts between employers and employees.

20 In the House of Lords' decision of *Herbert Morris Ltd. v. Saxelby*, [1916] 1 A.C. 688, Lord Atkinson made some observations on the difference between contracts of employment and those for sale of a business. He cited with approval *Leather Cloth Co. v. Lorsont* (1869), L.R. 9 Eq. 345, at p. 353, quoting James V.-C. in that case:

> The principle is this: Public policy requires that every man shall be at liberty to work for himself, and shall not be at liberty to deprive himself or the State of his labour, skill, or talent, by any contract that he enters into. On the other hand, public policy requires that when a man has by skill or by any other means

> obtained something which he wants to sell, he should be at liberty to sell it in the most advantageous way in the market; and in order to enable him to sell it advantageously in the market it is necessary that he should be able to preclude himself from entering into competition with the purchaser.

Lord Atkinson then stated that "[t]hese considerations in themselves differentiate, in my opinion, the case of the sale of goodwill from the case of master and servant or employer and employee" (p. 701).

21 The sale of a business often involves a payment to the vendor for goodwill. In consideration of the goodwill payment, the custom of the business being sold is intended to remain and reside with the purchaser. As Lord Ashbourne observed at p. 555 of *Nordenfelt*:

> I think it is quite clear that the covenant must be taken as entered into in connection with the sale of the goodwill of the appellant's business, and that it was entered into with the plain and bona fide object of protecting that business.

And as stated by Dickson J. (as he then was) in *Elsley v. J. G. Collins Insurance Agencies Ltd.*, [1978] 2 S.C.R. 916, at p. 924:

> A person seeking to sell his business might find himself with an unsaleable commodity if denied the right to assure the purchaser, that he, the vendor, would not later enter into competition.

See also *Burgess v. Industrial Frictions & Supply Co.* (1987), 12 B.C.L.R. (2d) 85 (C.A.), *per* McLachlin J.A. (as she then was), at p. 95.

22 The same considerations will not apply in the employer/employee context. No doubt an employee may build up a relationship with customers of the employer, but there is normally no payment for goodwill upon the employee leaving the employment of the employer. It is also accepted that there is generally an imbalance in power between employee and employer. For example, an employee may be at an economic disadvantage when litigating the reasonableness of a restrictive covenant because the employer may have access to greater resources (see, for example, *Elsley*, at p. 924, and *Mason v. Provident Clothing and Supply Co.*, [1913] A.C. 724 (H.L.), *per* Lord Moulton, at p. 745, quoted below at para. 33).

23 The absence of payment for goodwill as well as the generally accepted imbalance in power between employee and employer justifies more rigorous scrutiny of restrictive covenants in employment contracts compared to those in contracts for the sale of a business.

24 An initial question in the present case is whether the restrictive covenant at issue is properly characterized as being contained in an employment contract or a contract for the sale of a business. The December 31, 1987 agreement covering the sale of Shafron's business did not contain a

restrictive covenant. However, the agreement he entered into in early 1988 did. Whether the restrictive covenant in the 1988 agreement should be construed as being in relation to the sale of the business and the $700,000 goodwill payment is not the issue before the Court.

25 After Shafron sold his business, KRG Western was sold again in 1991 to Intercity. Shafron received no payment on account of goodwill when the shares of KRG Western were sold to Intercity. The contract in which the restrictive covenant at issue in this case was contained was entered into in 1998, some 11 years after Shafron sold his business and after it was sold a second time. The 1998 employment contract was entirely independent of the 1987 sale agreement and 1988 agreement. The fact that the restrictive covenant in the 1998 employment contract originated in the 1988 agreement has no bearing on the interpretation of the 1998 employment contract. The 1998 agreement is an employment contract and, as found by the trial judge, the reasonableness the restrictive covenant must stand up to the more rigorous test applicable to employment contracts.

B. *Determining Reasonableness*

26 As a general rule, according to Dickson J. in *Elsley*, at p. 925, the geographic coverage of the covenant and the period of time in which it is effective have been used to determine whether a restrictive covenant is reasonable. The extent of the activity sought to be prohibited is also relevant.

27 However, for a determination of reasonableness to be made, the terms of the restrictive covenant must be unambiguous. The reasonableness of a covenant cannot be determined without first establishing the meaning of the covenant. The onus is on the party seeking to enforce the restrictive covenant to show the reasonableness of its terms. An ambiguous restrictive covenant will be *prima facie* unenforceable because the party seeking enforcement will be unable to demonstrate reasonableness in the face of an ambiguity. As stated at the outset, the main difficulty that arises in this case is the ambiguity of the geographical restriction contained in the covenant. However, before turning to the case at hand, I will discuss the doctrine of severance as it applies to restrictive covenants in employment contracts.

28 As we see in this case, the limits on geographic scope often give rise to questions of severance. Can a restrictive covenant that is unreasonably wide in its geographic scope be severed in some manner so as to leave in place what the court regards as reasonable?

C. *Severance*

29 Where severance is permitted, there appears to be two types: "blue-pencil" severance and "notional" severance. Both types of severance have been applied in limited circumstances to remove illegal features of a contract so as to render the contract in conformity with the law. Blue-pencil severance was described in *Attwood v. Lamont*, [1920] 3 K.B. 571 (C.A.), by Lord Sterndale as "effected when the part severed can be removed by running a blue pencil through it" (p. 578). In *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7, [2004] 1 S.C.R. 249, Bastarache J., in dissent, described this form of severance at para. 57:

> Under the blue-pencil test, severance is only possible if the judge can strike out, by drawing a line through, the portion of the contract they want to remove, leaving the portions that are not tainted by illegality, without affecting the meaning of the part remaining.

30 Notional severance involves reading down an illegal provision in a contract that would be unenforceable in order to make it legal and enforceable (see *Transport*, at para. 2). In *Transport*, the contract provided that interest was to be charged at a rate exceeding 60 percent contrary to s. 347 of the *Criminal Code*. There was no evidence of an intention to contravene this provision, and this was not a case of loan sharking. Arbour J. applied the doctrine of notional severance to effectively read down the interest rate to the legal statutory maximum of 60 percent.

31 In *Transport*, a condition for application of the doctrine of notional severance appears to have been that what was illegal was easily determined by a bright-line provision in the *Criminal Code*. At para. 34, Arbour J. stated:

> This legislatively mandated bright line [of 60 percent] distinguishes s. 347 cases from those involving provisions, for example, in restraint of trade, where there is no bright line.

It is apparent that Arbour J. would not have applied the doctrine of notional severance where there was no bright-line test for illegality. (See also *Globex Foreign Exchange Corp. v. Kelcher*, 2005 ABCA 419, 262 D.L.R. (4th) 752, at para. 46.)

32 It must be recognized, however, that the court is altering the terms of the original contract between the parties by applying the doctrine of severance, whether blue-pencil or notional. In *Transport*, Arbour J. observed at para. 30, that "[i]ndeed, all forms of severance alter the terms of the original agreement". Where severance is applied, whether blue-pencil or notional, the purpose is to give effect to the intention of the parties when they entered into the contract. However, courts will be restrained in their application of severance because of the right of parties to freely contract and to choose the words that determine their obligations and rights.

D. *Blue-Pencil and Notional Severance Applied to Restrictive Covenants*

33 Where the provision in question is a restrictive covenant in an employment contract, severance poses an additional concern. While the courts wish to uphold contractual rights and obligations between the parties, applying severance to an unreasonably wide restrictive covenant invites employers to draft overly broad restrictive covenants with the prospect that the court will only sever the unreasonable parts or read down the covenant to what the courts consider reasonable. In *Mason*, Lord Moulton made the well-known statement to this effect at p. 745:

> It would in my opinion be pessimi exempli if, when an employer had exacted a covenant deliberately framed in unreasonably wide terms, the Courts were to

> come to his assistance and, by applying their ingenuity and knowledge of the law, carve out of this void covenant the maximum of what he might validly have required. It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is usually at a great disadvantage, in view of the longer purse of his master.

34 Lord Moulton did not foreclose severance entirely. However, he considered it exceptional and applicable only where there could be a clear severance and, even then, only where the excess was of a trivial or technical nature. He stated at p. 745:

> My Lords, I do not doubt that the Court may, and in some cases will, enforce a part of a covenant in restraint of trade, even though taken as a whole the covenant exceeds what is reasonable. But, in my opinion, that ought only to be done in cases where the part so enforceable is clearly severable, and even so only in cases where the excess is of trivial importance, or merely technical, and not a part of the main purport and substance of the clause. [Emphasis added.]

35 Other cases have accepted that severance might be applied if the severed parts are independent of one another or can be severed without the severance affecting the meaning of the part remaining. See, for example, *T. S. Taylor Machinery Co. v. Biggar* (1968), 2 D.L.R. (3d) 281 (Man. C.A.), at p. 290, *Putsman v. Taylor*, [1927] 1 K.B. 637 (Div. Ct.), at pp. 639-40, and *T. Lucas & Co. v. Mitchell*, [1974] Ch. 129 (C.A.), at p. 135.

36 I think the approach of Lord Moulton in *Mason* is the appropriate view of the law rather than the approach taken in the cases cited in para. 35 above. I am of the opinion that blue-pencil severance may be resorted to sparingly and only in cases where the part being removed is clearly severable, trivial and not part of the main purport of the restrictive covenant. However, the general rule must be that a restrictive covenant in an employment contract found to be ambiguous or unreasonable in its terms will be void and unenforceable.

37 However, I am also of the view that notional severance has no place in the construction of restrictive covenants in employment contracts. In my opinion, there are at least two reasons why it would be inappropriate to extend the doctrine of notional severance to the case of restrictive covenants in employment contracts.

38 First , there is no bright-line test for reasonableness. In the case of a contract that provides for an illegal rate of interest, for example, notional severance has been used to bring the rate down to the legal rate of 60 percent. In *Transport*, the evidence was that the parties did not intend to enter into an illegal contract, and what must be done to make the contract legal was quite clear. The Court inferred that the parties' original common intention was to charge and pay the highest legal interest rate and notional severance was applied to read down the rate to the highest legal rate.

39 In the case of an unreasonable restrictive covenant, while the parties may not have had the

common intention that the covenant be unreasonable, there is no objective bright-line rule that can be applied in all cases to render the covenant reasonable. Applying notional severance in these circumstances simply amounts to the court rewriting the covenant in a manner that it subjectively considers reasonable in each individual case. Such an approach creates uncertainty as to what may be found to be reasonable in any specific case.

40 Second , applying the doctrine of notional severance runs into the problem identified by Lord Moulton in *Mason*. It invites the employer to impose an unreasonable restrictive covenant on the employee with the only sanction being that if the covenant is found to be unreasonable, the court will still enforce it to the extent of what might validly have been agreed to.

41 Not only would the use of notional severance change the terms of the covenant from the parties' initial agreement to what the court thinks they should have agreed to, it would also change the risks assumed by the parties. The restrictive covenant is sought by the employer. The obligation is on the employee. Having regard to the generally accepted imbalance of power between employers and employees, to introduce the doctrine of notional severance to read down an unreasonable restrictive covenant to what is reasonable provides no inducement to an employer to ensure the reasonableness of the covenant and inappropriately increases the risk that the employee will be forced to abide by an unreasonable covenant.

42 For these reasons, the doctrine of notional severance does not apply in respect of restrictive covenants in employment contracts.

V. Application to this Case

43 Normally, the reasonableness of a restrictive covenant is determined by considering the extent of the activity sought to be prohibited and the extent of the temporal and spatial scope of the prohibition. This case is different because of the added issue of ambiguity. As indicated, a restrictive covenant is *prima facie* unenforceable unless it is shown to be reasonable. However, if the covenant is ambiguous, in the sense that what is prohibited is not clear as to activity, time, or geography, it is not possible to demonstrate that it is reasonable. Thus, an ambiguous restrictive covenant is, by definition, *prima facie* unreasonable and unenforceable. Only if the ambiguity can be resolved is it then possible to determine whether the unambiguous restrictive covenant is reasonable.

44 The trial judge found that there was no legal or judicial definition of the term "Metropolitan City of Vancouver". In finding that the spatial area covered by the restrictive covenant was not clear and certain, the trial judge referred to the evidence of the principal of KRG Western. At para. 56 of his reasons, he wrote:

> Mr. Meier's [principal of KRG Western] cross-examination at this trial was revealing as to what the parties had in mind when the phrase was used. At one point he testified that the phrase "means different things to different people". As

> his evidence progressed he thought that what was intended was the Greater Vancouver Regional District but "not Lion's Bay". At another point he indicated that it meant "Vancouver and suburbs" and finally he defined it on a population base indicating he thought it included "1.4 million people". During the course of his evidence he clearly indicated his belief that it was not limited to the City of Vancouver.

On the basis of this and other evidence, the trial judge found that the language of the restrictive covenant was neither clear nor certain and for this and other reasons dismissed the claim of KRG Western against Shafron.

45 The Court of Appeal agreed that the term "Metropolitan City of Vancouver" was ambiguous. At para. 59, Chiasson J.A. wrote:

> There is no fixed, recognized meaning for the phrase "Metropolitan City of Vancouver". Various suggested meanings were provided at trial and in this Court. They served merely to reinforce the ambiguity of the phrase.

46 However, the Court of Appeal was satisfied that "there is no doubt that the parties intended to prevent Mr. Shafron from competing in the City of Vancouver and an area beyond the City" (para. 80). It then determined that what "likely was in the reasonable contemplation of the parties when they made their agreement" (para. 63) was "the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby" (para. 61). In construing the ambiguous term "Metropolitan City of Vancouver" in the way it did, the Court of Appeal said that it relied on the doctrine of notional severance to resolve the ambiguity.

A. *Severance Cannot Be Invoked to Resolve the Ambiguity*

47 With respect, I do not think that what the Court of Appeal did constituted notional severance. As explained above, in *Transport*, notional severance was used to read down an illegal provision in a contract to render it legal. That is not what the Court of Appeal purported to do in this case. It was in fact trying to resolve the ambiguity in the term "Metropolitan City of Vancouver" by reading down covenant according to its notion of reasonableness and what it thought the parties might have intended (at paras. 59 and 63). As stated earlier, notional severance does not permit a court to rewrite a restrictive covenant in an employment contract in order to reflect its own view of what the parties' consensus *ad idem* might have been or what the court thinks is reasonable in the circumstances.

48 In the alternative, KRG Western submitted (at para. 116 of its factum) that, if this Court is unwilling to uphold the decision of the Court of Appeal which held that "Metropolitan City of Vancouver" should be read to include the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby that this Court should apply blue-pencil severance and remove the word "Metropolitan". In my view, blue-pencil severance does not apply here.

49 As I have stated, blue-pencil severance is to be applied narrowly, and only in particular circumstances. In *Canadian American Financial Corp.(Canada) Ltd. v. King* (1989), 60 D.L.R. (4th) 293 (B.C.C.A.), Lambert J.A. stated, at pp. 305-306, that

> the courts will only [apply blue pencil severance to] sever the covenant and expunge a part of it if the obligation that remains can fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agreed to it without varying any other terms of the contract or otherwise changing the bargain. ... It is in that context that reference is made in the cases severing and expunging merely trivial or technical parts of an invalid convenant, which are not part of the main purport of the clause, in order to make it valid.

50 Removal of the word "Metropolitan" would leave behind only "City of Vancouver". KRG Western, in its factum, stated that the "context makes it clear the parties intended the restricted area to cover not only the City of Vancouver, but also the suburbs immediately surrounding Vancouver" (para. 82). The Court of Appeal stated that the parties "clearly intended a geographic reach that included the City of Vancouver <u>and something more</u>" (para. 57 (emphasis added)). However, there is no evidence that the parties would have "unquestionably" agreed to remove the word "Metropolitan" "without varying any other terms of the contract or otherwise changing the bargain". Blue-pencil severance is therefore not applicable in this case.

B. *No Case Made Out for Rectification*

51 KRG Western in its factum says that it was obvious that "something must have gone wrong with the language" of the covenant and that "Metropolitan City of Vancouver" is a "mistaken description" (paras. 75 and 78). This submission and KRG's pleadings at first instance invite the Court to apply the doctrine of rectification to clarify the mistaken description.

52 However, this is not a case in which rectification is properly applicable. In *Frederick E. Rose (London) Ld. v. William H. Pim Jnr. & Co.*, [1953] 2 Q.B. 450 (C.A.), Denning L.J. stated at p. 461:

> Rectification is concerned with contracts and documents, not with intentions. In order to get rectification it is necessary to show that the parties were in complete agreement on the terms of their contract, but by an error wrote them down wrongly; and in this regard, in order to ascertain the terms of their contract, you do not look into the inner minds of the parties -- into their intentions -- any more than you do in the formation of any other contract.

Here, there was nothing to indicate what the parties intended by the use of the term "Metropolitan" when they entered into the covenant and nothing to indicate that they agreed on an area and then mistakenly wrote down "Metropolitan".

53 In *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, 2002 SCC 19, [2002] 1 S.C.R. 678, Binnie J., at paras. 37-40, set out the necessary requirements for rectification: (1) the existence and content of the inconsistent prior oral agreement; (2) that the party seeking to uphold the terms of the written agreement knew or ought to have known about the lack of correspondence between the written document and the oral agreement, in circumstances amounting to fraud or the equivalent of fraud; and (3) "the precise form" in which the written instrument can be made to express the prior intention.

54 In this case, KRG Western has shown no prior oral agreement, let alone the content of one. Rather, it simply asserts that "something must have gone wrong with the language" of the contract. Without pointing to a prior agreement that was departed from when the contract was put into writing, rectification is not available.

55 In Binnie J.'s discussion of the "precise form" requirement, at para. 40, he stated:

> The third hurdle is that Sylvan (Bell) [the respondent in that case] must show "the precise form" in which the written instrument can be made to express the prior intention (*Hart, supra, per* Duff J., at p. 630). This requirement closes the "floodgates" to those who would invite the court to speculate about the parties' unexpressed intentions, or impose what in hindsight seems to be a sensible arrangement that the parties might have made but did not. The court's equitable jurisdiction is limited to putting into words that - and only that - which the parties had already orally agreed to.

In my view, the Court of Appeal imposed what in hindsight seemed to it to be a sensible arrangement that the parties might have made, but did not.

56 I would also note Binnie J.'s comments, at para. 31:

> In *Hart, supra*, at p. 630, Duff J. (as he then was) stressed that "[t]he power of rectification must be used with great caution". Apart from everything else, a relaxed approach to rectification as a substitute for due diligence at the time a document is signed would undermine the confidence of the commercial world in written contracts.

57 In this case, KRG Western can point to no prior agreement, written or oral, that explains the term "Metropolitan City of Vancouver". Rectification is used to restore what the parties' agreement actually was, were it not for the error in the written agreement. In the present case, there is no indication that the parties agreed on something and then mistakenly included something else in the written contract. Rather, they used an ambiguous term in the written contract. The original restrictive covenant was drafted by a Toronto lawyer who apparently did not know that "Metropolitan City of Vancouver" was not a legally defined term. The doctrine of rectification is not applicable.

VI. Conclusion

58 In my respectful opinion, the Court of Appeal erred when it rewrote the restrictive covenant in this case to substitute for the "Metropolitan City of Vancouver" the "City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby". The term "Metropolitan City of Vancouver" was ambiguous and there was no context or other evidence demonstrating the mutual understanding of the parties at the time they entered into the contract as to what geographic area it covered. Further, the trial judge found that the restrictive covenant was unreasonable (para. 52). It was inappropriate for the Court of Appeal to rewrite the geographic scope in the restrictive covenant to what it thought was reasonable.

59 I would allow the appeal with costs here and in the courts below and restore the judgment of the trial judge dismissing KRG Western's action.

Solicitors:

Solicitors for the appellant: Clark Wilson, Vancouver.

Solicitors for the respondent: Lindsay Kenney, Vancouver.

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