COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: ***KRG Insurance Brokers (Western) Inc. v. Shafron,***
2007 BCCA 79

Date: 20070212

Docket: CA33390

Between:

KRG Insurance Brokers (Western) Inc.

Appellant
(Plaintiff)

And

Morley Shafron and Shaw Insurance Agency Ltd.

Respondents
(Defendants)

And

Shaw Sabey & Associates Ltd. and Prosperous Financial Insurance Services Ltd.

Defendants

Before: The Honourable Madam Justice Huddart
The Honourable Mr. Justice Thackray
The Honourable Mr. Justice Chiasson

T. Delaney and C. Martin	Counsel for the Appellant
D. W. Buchanan, Q.C. and V. S. Dixon	Counsel for the Respondents
Place and Date of Hearing:	Vancouver, British Columbia 14 November 2006
Place and Date of Judgment:	Vancouver, British Columbia 12 February 2007

Written Reasons by:
The Honourable Mr. Justice Chiasson

Concurred in by:
The Honourable Madam Justice Huddart
The Honourable Mr. Justice Thackray

Reasons for judgment of the Honourable Mr. Justice Chiasson:

Background

[1] This is an appeal from the dismissal of the appellant's action seeking to restrain the respondent Morley Shafron from carrying on business as an insurance agent in the metropolitan City of Vancouver contrary to the provisions of a restrictive covenant and from soliciting insurance business from any of the appellant's subsisting or former clients in breach of a fiduciary duty owed by the respondent to the appellant and for damages arising

therefrom. The action was dismissed by consent against two corporate defendants, but proceeded against Mr. Shafron and Shaw Insurance Agency Ltd.

[2] For the reasons that follow, I would allow the appeal and remit the matter to the Supreme Court to assess damages.

[3] In 1963 Mr. Shafron incorporated the appellant, an insurance agency business, which was known as Morley Shafron Agencies Ltd. The business has operated in the South Granville area of Vancouver since 1961. Pursuant to a share purchase agreement dated December 31, 1987, Mr. Shafron sold his shares in Shafron Agencies and the company changed its name to KRG Insurance Brokers (Western) Inc. The purchaser of Mr. Shafron's shares was an Ontario company, KRG Insurance Brokers Inc. It was owned by KRG Management Inc. The respondent was paid $700,000 for his shares by way of a cash payment of $300,000 and $400,000 in shares of KRG Management.

[4] At the time of the sale, Mr. Shafron was the only salesperson or "producer" employed by the business. This meant that his sales produced virtually all of the clients for the business.

[5] The share purchase agreement did not contain a restrictive covenant, but it included under the heading "Conditions Precedent to the Purchaser's Obligation to Purchase the Purchased Shares":

> The Vendor shall have entered into a shareholding and management agreement in substantially the form of the unexecuted agreement annexed hereto as Schedule H.

[6] Mr. Shafron fulfilled that condition when he entered into the Shareholding and Management Agreement (the "1988 Agreement") dated January 4, 1988.

[7] KRG Western was not a party to the 1988 Agreement.

[8] Under the 1988 Agreement, KRG Management agreed to:

> . . . cause [KRG Brokers] or [Shafron Agencies] to engage and continue to engage Shafron for the term of this agreement to provide to [KRG Management] in the Province of British Columbia such managerial and insurance brokerage services as may be required or reasonably requested by [KRG Brokers]. . .

KRG Management was to pay his expenses and compensation. Mr. Shafron agreed to continue his employment with the business until January 1, 1991. The 1988 Agreement also contained the following provisions:

> 9. Subject to the continuing effect of paragraphs 15, 21 and 22 hereof, this agreement shall be effective from the date hereof until January 1, 1991. On or before October 1, 1990, the parties hereto shall mutually determine their respective on-going relationship with respect to the provision by Shafron of managerial and insurance brokerage services hereunder. Upon the expiration of the term of this agreement, Shafron shall be deemed to retire under the provisions of paragraph 22 below. Notwithstanding the foregoing, the parties acknowledge that the provisions of this agreement with respect to the holding, disposing or transferring of Common Shares will survive any such relationship whereby Shafron is to provide managerial or insurance brokerage services. In addition, obligations and covenants of Shafron as set forth in paragraphs 10 and 11 below shall survive the termination of this agreement and shall [be] binding upon his successors and assigns.
>
> . . .
>
> 12. Shafron agrees that, upon his leaving the employment of [Shafron Agencies] or [KRG Brokers] for any reason save and except for termination by [KRG Brokers] 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.

[9] On February 28, 1991, Mr. Shafron and others entered into an agreement with KRG Western, KRG Brokers and KRG Management (the "1991 Agreement") for a term from January 1, 1991 to January 1, 1994. The 1991 Agreement provided that Mr. Shafron was to serve KRG Western as president and director and manage its day-to-day operations, under the overriding control of the management of KRG Management and the board of directors of KRG Western. Under this agreement, KRG Western was responsible for Mr. Shafron's expenses and compensation.

[10] The 1991 Agreement contained a restrictive covenant in substance the same as the restrictive covenant in the 1988 Agreement. It also contained provisions terminating the agreement on a sale of 50% or more of KRG Western's shares or assets and obliging Mr. Shafron to be employed by or to provide his services to the purchaser. KRG Management could sell only if the purchaser were to agree to employ Mr. Shafron and either assume the remuneration obligations of KRG Western under the 1991 Agreement or enter into another agreement acceptable to him.

[11] On July 31, 1991, Intercity Investment Corp. purchased KRG Western's shares from KRG Brokers. In an agreement of the same date (the "Intercity Agreement"), after reciting that a non-competition commitment from both KRG Brokers and Mr. Shafron was a condition precedent to Intercity's purchase, Mr. Shafron and KRG Brokers entered into a series of covenants not to carry on an insurance business. The covenants ranged in periods of time and areas described; the maximum area was within ten miles of the business location of KRG Western and the maximum period of time was five years and five months. The agreement contained a provision stating that the covenants were severable if unenforceable.

[12] On the next day, August 1, 1991, Mr. Shafron and KRG Western entered into a contract providing for the services of Mr. Shafron to the company (the "August 1991 Agreement"). The parties agreed that Mr. Shafron's employment was to commence on July 31, 1991 and terminate on January 1, 1994. After August 1, 1993, the parties were to, ". . . mutually determine the terms of any continuing relationship among themselves". Mr. Shafron's non-competition commitment was worded similarly to those included in the 1988 and the 1991 Agreements:

> 13. Shafron shall not, upon his leaving the employment of the Corporation for any reason, save and except for termination by the Corporation 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.

[13] On December 21, 1993, Mr. Meier, Intercity's president, wrote on the letterhead of KRG Western stating: "[f]urther to our recent discussions regarding your contract this is to confirm that we agreed to renew your contract for a further five years with an additional two year renewal option". There appears not to have been a written renewal of the additional two years, but it is clear on the evidence that the contract was so renewed.

[14] On November 29, 2000, Mr. Meier wrote to Mr. Shafron enclosing, ". . . a copy of the page from your original employment contract that deals with the duration of your contract". The page was from the August 1991 Agreement. Mr. Meier referred to the 1993 renewal and noted, ". . . your current employment contract will expire on January 1, 2001". Then he continued: "[y]ou recently indicated that you would like to continue as a Senior Account Executive for some time to come and I am certainly prepared to negotiate terms and conditions for continued employment with [KRG Western]". He suggested that he and Mr. Shafron meet for lunch, ". . . to discuss this further".

[15] Presumably pursuant to the letter, Messrs. Meier and Shafron met on December 5, 2000. The topic of their discussion appears to have been the remuneration of Mr. Shafron. Mr. Shafron, whose compensation was based on a salary, wanted to be paid on a straight commission basis. He had made the request a number of times previously without success and felt on this occasion, as in the past, that his concerns were not being addressed

effectively by Mr. Meier. Mr. Shafron testified:

> Q Now, sir, did you meet with Mr. Meier on December 5th, 2000?
>
> . . .
>
> All right, and can you tell His Lordship what happened on that occasion?
>
> A Well, specifically, we were there to discuss my compensation package and he said, "What do you want?" and I said, "Well, I want to change from a salary base to a straight commission base and I want 60 percent of the commissions, and he said no. That was the end of that. He said what he would do, he would think over the compensation package and get back to me. Well, that was a famous line of his, because he always shelves things on the back burner and never got back.

[16] On December 11, 2000, Mr. Shafron wrote to KRG Western stating that he would not be renewing his contract and that he would vacate his office at the close of business on December 29, 2000.

[17] The parties met again later in December and in early January 2001 and discussed the possible acquisition by Mr. Shafron of an insurance agency owned or controlled by Mr. Meier located in Richmond, British Columbia, a municipality adjacent to the City of Vancouver, but this did not occur. Thereafter, Mr. Shafron began to work as an insurance broker with Shaw Insurance Agency Ltd. from its office in Richmond. He undertook some limited advertising concerning his new position. A significant number of his former customers moved their business from KRG Western to Mr. Shafron and his new employer.

[18] The Plaintiff sued to enforce the restrictive covenant and for breach of fiduciary duty.

The Trial Judgment

[19] The trial judge identified the issues in the case in para. 28 of his reasons for judgment: (***KRG Insurance Brokers (Western) Inc. v. Shafron*** (2005), C.C.L.I. (4th) 187, 2005 BCSC 1611.)

> (1) The reasonableness and the enforceability of the restrictive covenant.
>
> (2) The meaning of the phrase "Metropolitan City of Vancouver".
>
> (3) The possible rectification of the contract by substituting other descriptions for "Metropolitan City of Vancouver".
>
> (4) Privity of the plaintiff to the 1988 contract.
>
> (5) The applicability of the principles established in ***Trego v. Hunt*** [[1896] A.C. 7 (H.L.)].
>
> (6) Fiduciary duty and obligations.
>
> (7) Is there a breach of a covenant with respect to confidential information?
>
> (8) Damages.
>
> (9) The [respondent's] counterclaim for unpaid commissions.

[20] The judge first dealt with the restrictive covenant starting from the proposition that, ". . . a restrictive covenant in restraint of trade is against public policy and is generally unenforceable". After referring to a number of authorities that addressed restrictive covenants in the context of an employment contract, the judge quoted from McLachin J.A., in ***Burgess v. Industrial Frictions & Supply Co. Ltd.*** (1987), 12 B.C.L.R. (2d) 85 (C.A.) at 95:

> In determining whether a covenant in restraint of trade is enforceable, a covenant exacted by a purchaser from a vendor on a sale of the goodwill of the business stands on a different footing than an employment contract*:* …Contracts of employment in restraint of trade are viewed by the law as prima facie offensive and are liable not to be enforced, in the absence of special circumstances such as a close personal relationship between the employee and the employer's customers: …The opposite approach applies to contracts for the sale of the goodwill of a business. It is the policy of the law and in the public interest that a contract for the sale of a business fully entered into should prima facie be enforced: …It is reasonable that a vendor would seek to protect a business against the competition of an outgoing partner: …The remaining partner's livelihood depends substantially on the goodwill created and on the extent to which he or she is able to preserve it. It is, in short, a proper matter for protection.
>
> [Citations omitted.]

[21] The judge rejected the plaintiff's contention that the restrictive covenant should be construed as contained in the 1988 Agreement. He stated in para. 38 of his reasons for judgment, "I reject the [appellant's] submission that 'the later agreement still arose out of the same factual matrix that included the sale and those agreements should still be subjected to the analysis applied to a covenant arising out of the sale of a business'" and in para. 44, ". . . this is . . . a case of an employer seeking to enforce a term of an employment contract".

[22] The judge concluded in para. 45 of his reasons for judgment, "[t]he authorities make it clear that the enforceability of a restrictive covenant in the case of a sale of goodwill is an exception to the general rule, the onus lies on the plaintiff to establish that they come within it, and they have failed to do so" and stated in para. 46, "[i]f I am incorrect in the conclusion I have reached I will go on to consider the test identified by Brenner J. in [***Aurum Ceramic Dental Laboratories Ltd. v. Hwang***, [1998] B.C.J. No. 190 (S.C.)]".

[23] ***Aurum*** concerned the granting of an interlocutory injunction. The principal focus of the case was on the balance of convenience. Arguably, the articulation of the criteria by Mr. Justice Brenner was *obiter dicta*, but it is a good recapitulation of the position taken by courts and has been followed. (See: ***Unisource Canada Inc. v. Network Paper and Packaging Ltd.***, 2000 BCSC 396; ***Napier Environmental Technologies Inc. v. Vitomir***, 2002 BCSC 716; ***MD Management Ltd. v. Dhut***, 2004 BCSC 513; and, ***Yellow Pages Group v. Anderson Co.***, 2006 BCSC 518.)

[24] Brenner J. stated the criteria in para. 11 of his reasons for judgment as follows:

> For a "post-employment" restraint to be enforced, the Courts have required the parties seeking to uphold the restraint to prove that the restraint has the following characteristics:
>
> (a) it protects a legitimate proprietary interest of the employer; (b) the restraint is reasonable between the parties in terms of:
>
> (I) temporal length;
> (ii) spatial area covered;
> (iii) nature of activities prohibited; and
> (iv) overall fairness;
>
> (c) the terms of the restraint are clear, certain and not vague; and
>
> (d) the restraint is reasonable in terms of the public interest with the onus on the party seeking to strike out the restraint.

[25] The judge found the restraint in the covenant to be unreasonable (para. 52), neither clear nor certain (para. 57), and far wider than necessary to protect the appellant's interests (para. 59). Consequently, he refused to enforce it.

[26] The judge also concluded there was no fiduciary relationship. I agree that the evidence did not establish a fiduciary relationship. Mr. Shafron was a very important employee, but the evidence is clear that for some time prior to December 2000 he did not exercise managerial authority in the appellant's organization and had a limited ability to bind the appellant contractually. While Mr. Shafron had considerable influence with the appellant's customers, with a consequential risk of loss of customers to KRG Western if Mr. Shafron were to compete with it, there was no power imbalance between the parties and so, these factors do not support the existence of a fiduciary relationship in the circumstances.

[27] I also agree with the judge that the applicable restrictive covenant is that contained in the August 1991 Agreement, but as renewed in 1998. I am persuaded he erred when he refused to enforce it on the facts of this case, in light of the authorities by which the judge was guided and other recent authorities in this Court and the Supreme Court of Canada.

Preliminary Comment

[28] At the hearing in this Court, appellant's counsel advised the Court that the appellant did not pursue its privity argument and I shall not address that subject.

[29] The appellant also did not rely on ***Trego v. Hunt*** or rectification. I make no comment on the latter.

[30] ***Trego v. Hunt*** stands for the proposition that at common law there is an implied prohibition on a vendor soliciting the customers of the business that has been sold. The corollary of this is that an express provision dealing with competition ousts the implied term. The principle derives from the sale of goodwill context. Its applicability to the case at bar is questionable.

[31] In para. 85 of his reasons for judgment, the learned trial judge stated:

> The application of this principle does not allow for the substitution of the implied obligation in the event the express covenant is found to be unenforceable for the logic proceeds on the basis that the parties by their actions have made their own agreement and by necessary implication excluded the operation of the implied obligation.

[32] While there is some authority to support this conclusion (see: ***Canadian Fur Auction Sales Co. (Quebec) Ltd. v. Neely*** (1954), 11 W.W.R. (N.S.) 254 (Man. C.A.)), it merits further examination.

[33] Consideration of this issue may depend on the legal characterization of "unenforceable". Mr. Justice Toy, as he then was, stated in ***Salloum*** at 257, quoting from ***Mason v. Provident Clothing & Supply Co. Ltd.***, [1913] A.C. 724 (H.L.) at 732: ". . . the question is not whether [the parties] could have made a valid agreement, but whether the agreement actually made was valid". (This passage was cited by Mr. Justice Dickson in ***Elsley v. J.G. Collins Ins. Agencies***, [1978] 2 S.C.R. 916 at 925.)

[34] If this were to mean that the restrictive covenant was void *ab initio* or even voidable (***Mason*** at 745 refers to the offending restrictive covenant as "void"), would it continue to operate to supplant an implied obligation? It seems to me that this may amount to giving legal effect to an illegal covenant to take away a legal result which otherwise would apply to the parties; while its validity is denied, it is said that the covenant actually supplants the common law implied prohibition. I question whether an invalid agreement can supplant the law that otherwise would apply to parties.

Discussion

The applicable contract and relationship

[35] The parties to the 1988 Agreement and the subsequent agreements containing the restrictive covenant at issue on this appeal differ, as do their objectives. In the former agreement, KRG Management, as the ultimate

purchaser, like Intercity in July 1991, sought protection for its investment. Its purpose was to protect the goodwill it had purchased. Without Mr. Shafron's covenants to KRG Management, KRG Brokers was not obliged to buy the shares of Shafron Agencies. There was no need for KRG Western to be a party to the 1988 Agreement. Its ultimate owners had committed to cause it to employ Mr. Shafron and had obtained the restrictive covenant from him. KRG Western benefited from that agreement.

[36] On the expiry of the employment term in the 1988 Agreement, it became necessary to forge a direct employment relationship between the parties. Mr. Shafron then entered the 1991 Agreement with KRG Western, as well as KRG Management, and KRG Brokers. That agreement established the first direct contractual relationship between the parties. It included terms for the provision of Mr. Shafron's services to KRG Western among which was a restrictive covenant. While KRG Western was a beneficiary of its ultimate parent's 1988 Agreement with Mr. Shafron, it can now benefit only from the agreements it or its current parent made with him. KRG Western is not entitled to enforce the restrictive covenant in the 1988 Agreement.

[37] In addition to the realities of the commercial relationships, the terms of the 1988 Agreement appear to defeat any idea that KRG Western has rights under it. Paragraph 9 of the 1988 Agreement states the term of the agreement and lists the provisions of the agreement that survive. Paragraph 12, the restrictive covenant, is not one of them. Pursuant to paragraph 9, Mr. Shafron was deemed to retire at the end of the term. That is, contractually, at a maximum, he was to leave employment at the end of the term and the three-year prohibition was in place. On this analysis, clearly the 1991 Agreement was essential and clearly the 1988 Agreement and its restrictive covenant are not available to KRG Western.

[38] The effect of the Intercity Agreement was that KRG Brokers and Mr. Shafron could not compete with Intercity before January 1, 1997. Separately, in the August 1991 Agreement, they agreed on the terms of Mr. Shafron's continuing provision of services to KRG Western that included a non-competition clause essentially the same as that in the 1991 Agreement. They renewed that agreement until December 31, 2000, when Mr. Shafron left the appellant's employ. This is the restrictive covenant whose enforceability is at the root of this appeal.

The enforceability of the restrictive covenant

[39] The appellant contends that even if the restrictive covenant is to be considered in the employment context, placing it into its factual matrix allows the Court to apply the approach usually taken to covenants in the context of the sale of goodwill when deciding whether to enforce it.

[40] The Supreme Court of Canada rejected this proposition in ***Elsley***. After noting that the Ontario Court of Appeal considered the case did not fit neatly into the category of either employment or sale of goodwill, Dickson J. stated, ". . . I do not think the restrictive covenant of the employment agreement can be fed by the sale agreement. . . It would be wrong. . . to test that agreement by the criteria applicable in the case of a vendor/purchaser agreement, or by some hybrid test".

[41] ***Elsley*** is an excellent starting point for the analysis of the enforceability of Mr. Shafron's covenant, particularly this admonition of Dickson J. at 923-24:

> It is important . . . to resist the inclination to lift a restrictive covenant out of an employment agreement and examine it in a disembodied manner, as if it were some strange scientific specimen under microscopic scrutiny.

[42] The significance of this admonition is reflected at 926, when, after noting that Mr. Elsley's covenant was not given in a conventional employer/employee situation, he observed:

> . . . Whether a restriction is reasonably required for the protection of the covenantee can only be decided by considering the nature of the covenantee's business and the nature and character of the employment.

[43] Dickson J. had begun his analysis at 923:

> . . . A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest . . . competing demands must be weighed. There is an important public interest in discouraging restraints on trade, and maintaining free and open competition unencumbered by the fetters of restrictive covenants. On the other hand, the courts have been disinclined to restrict the right to contract, *particularly when that right has been exercised by knowledgeable persons of equal bargaining power*. In assessing the opposing interests the word one finds repeated throughout the cases is the word 'reasonable'. The test of reasonableness can be applied . . . only in the peculiar circumstances of the particular case. Circumstances are of infinite variety. Other cases may help in enunciating broad general principles but are otherwise of little assistance.
>
> [Emphasis added.]

[44] In discussing the difference between employment and purchase and sale agreements, Dickson J. wrote at 924:

> A different situation, *at least in theory*, obtains in the negotiation of a contract of employment where *an imbalance of bargaining power may lead to oppression* and a denial of the right of the employee to exploit, following termination of employment, in the public interest and in his own interest, knowledge and skills obtained during employment.
>
> [Emphasis added.]

[45] This comment provides useful background for the instructive comments of McLachlin J.A., at 93 in ***Burgess***:

> . . . I start with the fundamental principle of construction that all provisions of an agreement should be given their full, plain and ordinary meaning unless it is impossible to do so. In some cases it may be necessary to vary the ordinary meaning of the words the parties have chosen in order to give effect to their intentions. . . Nevertheless, judicial reluctance to alter or 'read down' contractual provisions remains one of the cornerstones of freedom of contract and the right of parties to define their own obligations. . .

[46] The reluctance McLachlin J.A. expressed in ***Burgess*** "to alter or 'read down'" contractual provisions must now be read in light of recent decisions on the doctrine of severance. Severance is one of the tools available to courts seeking to reconcile the tension inherent in the construction of commercial contracts so as to effect the parties' intentions and preserve the integrity of their bargain so far as possible while giving due weight to the policy reasons giving rise to the alleged illegality.

[47] This Court considered the doctrine of severance recently in the employment context in ***ACS Public Sector Solutions Inc. v. Courthouse Technologies Ltd.*** (2005), 48 B.C.L.R. (4th) 328, 2005 BCCA 605. At para. 50, Donald J.A. explained:

> The doctrine of severability is more rigorously applied to restrictive covenants negotiated between employer and employee; *the primary rationale is the imbalance of power* which often leaves the employee with little room to manoeuvre in the negotiations. The policy of the law is to discourage employers from using their dominant position to extract unreasonable terms.
>
> [Emphasis added.]

I note that this observation is consonant with the view expressed by Dickson J. in ***Elsley***.

[48] Mr. Justice Donald's reasoning was influenced by that of Arbour J. in ***Transport North American Express Inc. v. New Solutions Financial Corp.***, [2004] 1 S.C.R. 249, 2004 SCC 7. In that decision, the court responded to criticism of the "blue pencil" rule, like this of Lambert J.A. offered in ***Canadian American Financial Corp. (Can.) v. King*** (1989), 36 B.C.L.R. (2d) 257 at 271:

> . . . The rule is overly artificial and places too much stress on the words chosen to express the intention of the parties and not enough stress on the intention of the parties themselves. In my opinion, the "blue pencil" rule in its strict form, as I have stated it, should not be considered as a rule of law and should not be applied as such in British Columbia. It should be regarded only as an aid to determining whether the case is an appropriate one for severance. . .

[49] ***Transport North American*** was an appeal from the Ontario Court of Appeal and concerned criminal interest. The central issue in the case was stated in para. 4 to be: ". . . whether notional severance . . . is valid in Canadian law and applicable here". A key consideration for the Ontario Court of Appeal and the Supreme Court of Canada was the application of the "blue pencil" test. Arbour J. addressed the issue in paras. 28 and 30:

> The use of the blue-pencil approach to sever one or more provisions from a contract alters the terms of the agreement between the parties. The only agreement that one can say with certainty the parties would have agreed to is the one that they actually entered into. The insistence in the case law that the blue-pencil test derives its validity from refusing to change or add words or provisions to the contract is unconvincing. It is doubtful, for example, that the lenders in cases such as *Thomson*, *supra*, or *Mira Design Co., supra*, would have entered into the agreements at issue had they been aware *ex ante* that they would only be entitled to the return of the principal advanced. The change effected by the blue-pencil technique will often fundamentally alter the consideration associated with the bargain and do violence to the intention of the parties. Indeed, in many cases, the application of the blue-pencil approach will provide for an interest-free loan where the parties demonstrated in the agreement a clear intention to charge and pay considerable interest.
>
> . . .
>
> . . . I am in complete agreement with the conclusion that when a court employs the blue-pencil test, it is making a new agreement for the parties. Indeed, all forms of severance alter the terms of the original agreement.

[50] After examining three examples which gave three different results using the "blue pencil" approach, Arbour J. commented at para. 38:

> . . . Results this erratic and sensitive to the form of contractual expression are undesirable, and can be avoided through the use of notional severance in cases where considerations flowing from the broad contractual context favour the lender.

[51] At para. 41, she stated for the majority, ". . . the maximum level of remedial flexibility should be vested in judges and available for application by them subject to a careful analysis of the factors identified in *Thomson. . .* ."

[52] In ***ACS***, after quoting from Justice Arbour's discussion of the "blue pencil" test, Donald J.A. concluded, in paras. 58–59:

> . . . [T]he Supreme Court of Canada reversed the Ontario Court of Appeal, which blue pencilled the agreement to bring the rate of interest well under 60 per cent, and restored the trial judge's notional severance, which simply read down the agreement to 60 per cent.
>
> In my view, the spectrum theory endorsed by the Supreme Court of Canada applies to any illegal contract provision, whether by common law or statute. . .

[53] This theory is helpful in this case where the parties' words of geographic limitation have no easily ascertainable precise meaning, but express a clear intention to protect some spatial area from competition.

[54] The Supreme Court of Canada rejected a narrow approach to severance and endorsed "remedial flexibility" with the objective of giving effect to the ". . . substance of the bargain or consideration involved" rather than allowing the result to be,
". . . dependent upon accidents of drafting and the form or expression of [an] agreement" (***Transport North American*** at paras. 5 and 33). It has recognized that all forms of severance alter the terms of the original agreement and has accepted an approach which reads down contractual provisions to cure illegality, as long as the legally legitimate intentions of the parties reasonably are respected.

[55] There can be no doubt that the parties intended to restrict Mr. Shafron's ability to compete with the appellant after he left the appellant's employ. The simple fact is that the parties intended to limit Mr. Shafron's ability to compete for a period of time and within a geographic area that at the time they contracted the parties thought were reasonable.

[56] In the circumstances of this case, Mr. Shafron should be held to his bargain if the Court reasonably can oblige him to do so.

[57] In this case, the real difficulty arises from the parties' agreement to the geographic reach of the restrictive covenant as the "Metropolitan City of Vancouver". To strike the word "metropolitan" would not reflect the obvious intention of the parties. They clearly intended a geographic reach that included the City of Vancouver and something more. The "blue pencil" approach would distort that intention.

[58] The phrase appears to have originated with lawyers in Toronto for whom the word "metropolitan" may have had a clear meaning considering municipal organization in that area at the time of the 1988 Agreement. The meaning is less clear in Vancouver.

[59] 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 serve merely to reinforce the ambiguity of the phrase. The task at hand is to construe that word to attempt to give effect to the intentions of the parties and, if necessary, to proceed by way of notional severance. The question is whether that ambiguity can be resolved so as to give effect to the intention of the parties.

[60] To construe the phrase "Metropolitan City of Vancouver" as was suggested at the hearing, to mean the Greater Vancouver Regional District would give to the restrictive covenant an unreasonable reach, a spatial area that was unlikely to have been in the contemplation of the parties when they made their agreement and not necessary to protect the KRG Western's legitimate interest in its customer base. That base was in the south-western area of the City of Vancouver where its business was located and in municipalities reasonably close to the area, although Mr. Shafron did have customers in locations considerably distant from his office.

[61] In view of the clear direction of the Supreme Court of Canada that it is permissible to use notional severance to attempt to give effect to the substance of an agreement and to avoid having that substance subverted by an unfortunate choice of language, I would construe "Metropolitan City of Vancouver" to prevent Mr. Shafron from competing in the City of Vancouver and municipalities directly contiguous to it. Geographically, I would include the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby.

[62] This results in excluding from the definition of "Metropolitan City of Vancouver" geographic areas that clearly go beyond the reasonable need to protect the business, but which come within the phrase.

[63] By reading down the phrase "Metropolitan City of Vancouver" to an area consistent with the need to protect KRG Western's business, an area that likely was in the reasonable contemplation of the parties when they made their agreement, the substance of their bargain is respected and enforced. To do otherwise would be to allow form to triumph over substance; to ignore the parties' express intention to limit competition, and to allow Mr. Shafron to

walk away from a bargain he made repeatedly over many years to his benefit and to KRG Western's corresponding loss.

[64] In my view, this reading of the spatial restraint is permitted when regard is had to the four criteria Arbour J. identified as relevant ". . . to the determination whether public policy ought to allow an otherwise illegal agreement to be partially enforced rather than being declared void *ab initio* in the face of illegality in the contract." They derive from ***William E. Thomson Associates Inc. v. Carpenter*** (1989), 69 O.R. (2d) 545 (C.A.), also a criminal interest case.

[65] Criterion one: would the purpose of the law's reluctance to enforce covenants in restraint of trade in the employment context be subverted? I think not. As I noted, at the core of the concern with restrictive covenants in the employment context is a real or potential power imbalance between the employer and the employee.

[66] In this case, it cannot be said that there was a power imbalance between Mr. Shafron and KRG Western. Mr. Shafron's personal links to KRG Western's customers were significant. Where he went they were likely to go, with or without solicitation; as the evidence established, they did so apparently with minimal advertising. The various agreements reflected his effective veto on the sale of the business and KRG Western's legitimate desire to protect its book of business (or trade connection, in the words of Dickson J. in ***Elsley***). Given the personal relationship between Mr. Shafron and KRG Western's customers, the non-competition covenant he signed was probably the only way KRG Western could protect its legitimate interest in them.

[67] No one suggested there was a shortage of general insurance agencies to serve the public. Mr. Meier himself controlled 51 retail offices in the Lower Mainland at the time of the trial.

[68] Criterion two: did the parties enter into the agreement for an illegal purpose or with an evil intention? There is no evidence that would support such a conclusion.

[69] Criterion three: I have addressed the relative bargaining position of the parties.

[70] Criterion four: the potential for Mr. Shafron to enjoy an unjustified windfall. In my opinion, there is such a potential. There can be no question that KRG Western had a proprietary interest of value that was entitled to protection. The three-year restrictive covenant to protect that interest was renewed finally in 1998. Within two years Mr. Shafron left KRG Western and went into competition with it. He acquired a significant number of KRG Western's customers after leaving, in large part because he was its major producer, having served the customers personally for over 40 years.

[71] It is suggested that the length of the restriction is at the top-end of the usually acceptable, but taking into account the relationship of the parties and the fact that in the summer of 1991 they addressed the matter specifically and agreed to different spatial areas and lengths for covenants in two separate contracts to serve the different purposes of the different parties, then renewed the August 1991 Agreement for two years in 1998 after the covenant in the Intercity Agreement had expired, I am of the view that a three-year prohibition is not offensive.

[72] Reliance was placed on Aust *et al* eds., ***Executive Employment Law***, looseleaf (Toronto : Butterworths, 1993), at para. 11.23, "[a] clause exceeding two years in duration will be reasonable only in exceptional cases". I see no inherent reason for this and note that the authors begin their comment with the statement: "[a]lthough each case will turn on its own particular circumstances. . . .", an observation with which I agree and which is consonant with the comments of Dickson J. in ***Elsley*** at 923: "[t]he test of reasonableness can be applied . . . only in the particular circumstances of the particular case. Circumstances are of infinite variety. Other cases may help in enunciating broad general principles but are otherwise of little assistance".

[73] Discussing the approach taken to restrictive covenants in the context of the sale of goodwill, in paras. 41 and 42 of his reasons for judgment the learned trial judge stated:

> The efficacy of extending such protection . . . erodes with the passage of time. What may have been reasonable at the time of the sale in 1988 cannot necessarily be viewed as reasonable 12

> years [later] in December 2000.
>
> The exception identified in [*Phillips v. Campbell*, [1994] B.C.J. No. 3241 (S.C.)] loses its force over time as the purchaser has time to secure its own goodwill and establish its business.

Phillips states that a covenant in restraint of trade is enforceable if it is reasonable in reference to the interests of the parties, so as to afford adequate protection to the party seeking protection, and in reference to the public interest, so as to not be injurious to the public.

[74] When assessing the reasonableness of the restrictive covenant in this case the learned trial judge stated in para. 50: ". . . the circumstances present here do not support the reasonableness of a lengthy restrictive covenant 12 years after the original transaction".

[75] I do not share his view of the effect of the passage of time on the reasonableness of a restrictive covenant and consider that it may have drawn him into error.

[76] The judge's view appears not to be consonant with authority (see: ***Doerner v. Bliss & Laughlin Industries Inc.***, [1980] 2 S.C.R. 865 at 879 and ***Canadian American Financial Corp. (Can.) v. King*** (1989), 36 B.C.L.R. (2d) 257 at 262: although changed circumstances in the relationship between parties and in the marketplace may affect the reasonableness of a restrictive covenant, *prima facie* the reasonableness of a covenant should be considered with reference to the time when it was given). Although, as asserted by the respondent, the purchaser may have had time to recoup its investment or a large part of it, this may not take into account the fact that an objective of the purchaser likely was to increase the goodwill by relying on the ability of the covenantor and by building on the goodwill that was there at the time of the acquisition. It is also questionable whether the mere effluxion of time makes unreasonable and unenforceable a covenant which was reasonable and enforceable when the parties contracted.

[77] Mr. Shafron committed to the same three-year restriction for 12 years, through the 1988 Agreement, the 1991 Agreement, the August 1991 Agreement and two renewals of the latter. The price to Mr. Shafron of not continuing in KRG Western's employ would be a move beyond the geographic limit of the non-competition agreement or three years of inactivity. Mr. Shafron made his choice on each of those occasions fully aware of the agreement he was making and presumably was compensated to his satisfaction for the choice he made until December 2000. In so doing, he successfully deferred a three-year period of restricted activity in the general insurance business until then. Similarly, KRG Western would pay the price of losing the producer with long ties to its customers. By the renewal of the agreement in 1998, it accepted that reality. In the language of the authorities, the restrictive covenant was agreed to by knowledgeable persons of equal bargaining power.

[78] KRG Western made choices too. It paid whatever price was required to reach agreement for the continued assistance of its primary producer with long well-established ties to its customers until the final renewal in 1998. In so doing, it avoided the risk of loss of his clients to another producer that it would now face if they had not gone to Mr. Shafron and his new employer, but it would have retained for three years the benefit of the non-competition clause in the August 1991 Agreement as renewed in 1998.

[79] Two parties of equal bargaining power made a bargain with a temporal restriction on competition they must both be taken to have considered reasonable when they last made it in 1998. Given that fact and Mr. Shafron's 40-year relationship with his employer's customers, I am persuaded a three-year restriction on competition to begin at the termination of that contract falls within the range of what reasonable people would consider necessary to protect KRG Western's legitimate proprietary interest.

[80] In summary, I conclude that the restrictive covenant in this case is reasonable between the parties in terms of its temporal length, the spatial area covered, the nature of the activities prohibited and its overall fairness. The terms of the covenant are clear, certain and not vague in 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. Taking into account the commercial circumstances of the business and the parties, a reasonable construction of the word "Metropolitan" is

possible. The restraint is reasonable in terms of the public interest considering the nature of the business and the availability of general insurance agencies to the public in the area covered by the restraint. There is little to support a conclusion that in the circumstances of this case, a restriction of three years is unreasonable.

Conclusion

[81] I would allow the appeal and direct that the matter be referred to the Supreme Court for an assessment of damages based on a three year restrictive covenant that prohibits Mr. Shafron from directly or indirectly carrying on, being employed in, or being interested in or permitting his name to be used in conjunction within the business of insurance brokerage which is carried on within the area of the City of Vancouver, the University of British Columbia Endowment Lands, Richmond and Burnaby, as they are organized under Provincial law.

"The Honourable Mr. Justice Chiasson"

I agree:

"The Honourable Madam Justice Huddart"

I agree:

"The Honourable Mr. Justice Thackray"