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LEGAL BYTES

EMPLOYERS BEWARE!

Non-competition clauses signed by employees may not be enforceable

Carol V. Kljajo

You may believe you are protecting yourself by having your employees sign comprehensive non-competition clauses, but beware. If the clause is too far reaching, unreasonable or ambiguous, it may not be valid and enforceable.

On January 23, 2009, Canada's highest Court reaffirmed that it is not the Court's role to "fix" an unreasonable or ambiguous non-competition clause (also known as a "restrictive covenant") in order to render it valid. In other words, if the restrictive covenant is unreasonable or unclear, it may be struck down and the employer will be left without the protection he thought he had.

The Supreme Court of Canada

In the case of *Shafron v. KRG Insurance Brokers (Western) Inc.*, [2009 SCC 6], Mr. Shafron sold his Vancouver-based insurance business with the agreement that he would stay on to provide management services to the company. His employment agreement included a non-competition clause which prohibited him from engaging in the insurance brokerage business "within the metropolitan City of Vancouver" for a period of three years after the termination of his employment with KRG. In 2001, Mr. Shafron left KRG and began working as an insurance salesman in Richmond, British Columbia. KRG sued Mr. Shafron seeking to have his restrictive covenant enforced. Shafron challenged the enforceability of the restrictive covenant on the basis that there was no recognized meaning for the phrase "Metropolitan City of Vancouver." In an attempt to clarify the meaning of "Metropolitain City of Vancouver", KRG had argued that the intended geographic scope was "the University of British Columbia endowment lands, Richmond and Burnaby" notwithstanding the term "Metropolitan City of Vancouver". The Court determined that such a rectification was not possible because the employer could not point to any evidence of the mutual understanding between the parties that had been incorrectly recorded in the final written form. When it was suggested that the word "metropolitan" simply be removed in order to leave just "City of Vancouver", it was determined that such a rectification was also inappropriate as the employer insisted that the parties had agreed to something broader than that. It was ultimately held that the clause could not be rectified to correct what had "gone wrong with the language". Such a "notional" approach of reading down a contractual provision so as to make it legal and enforceable was rejected by the Court. It was held that the expression "Metropolitan City of Vancouver" was neither clear nor certain, and as such the restrictive covenant could not be validly upheld and enforced. The only case in which the Court would consider striking out "merely trivial or technical parts" of a clause in order to make it valid is where it is clear that such a striking out would not fundamentally change the bargain. This latter, acceptable approach is referred to as the traditional "blue pencil" approach.

The Court further stated that it is not for the Court to step in and impose a meaning on an ambiguous clause that the parties themselves did not intend. Ruling otherwise would "invite the employer to impose an unreasonable restrictive covenant on the employee" given that the employer could rely on the Court to read down the language and enforce such a restrictive covenant."

The Law in Quebec

In Quebec, non-competition agreements are expressly governed by Article 2089 of the Civil Code of Quebec which provides that a non-competition clause must be limited as to **time**, **place** and **type of employ-**

ment and whatever is necessary **for the protection of the legitimate interests of the employer**, failing which it will not be enforceable.

Employers must beware of unreasonably broad geographic restrictions such as “anywhere in the world” or even “anywhere in North America”, depending on the circumstances. Imposing a non-competition period of 10 years, 3 years or even 1 year may also be considered unreasonable depending on the industry and nature of employment in question. Employers must consider only such post-employment restrictions as a court would consider reasonable under the circumstances otherwise they may be leaving themselves completely unprotected. It is also recommended that the necessity and reasonableness of such restrictions be reassessed each time an employment contract is up for renewal as circumstances do change.

Conclusion

Canadian courts are acutely aware of the imbalance in power that generally exists between employers and employees. As a result, employers who try to include too many restrictions with overly broad language in their restrictive covenants may be left without any protection at all.

BASIC CONSIDERATIONS IN ESTATE PLANNING

Wolfe M. Friedman, Q.C.

Frequently asked questions posed by persons planning their will include how to distribute their assets among the various family members and who should be made the executors, referred to today as the “Liquidators”. Let me propose some possibilities to a few of these queries.

Before discussing the distribution of the assets of a person making a will, that person, the testator in legal speak, should understand some basic income tax considerations that will almost always come into play.

Deemed Disposition of Assets at Death

The most basic of these income tax laws provide that upon death a testator is considered to have disposed of **all** of his assets immediately prior to his death at their then fair market values, including shares in **any** company or corporation that he may own at that time.. This is called a “deemed disposition”, since there is no actual disposition of his property. The recipient of those assets, for income tax purposes, is the estate of the testator. This means that at a moment immediately prior to death the testator will be deemed to have realized all of his capital gains and capital losses on all of his capital assets, and, subject to certain exceptions, the estate will be responsible for the payment on behalf of the deceased, of any taxes becoming payable as a result of that deemed disposition. It is important to note that it is not the heirs who are liable for the payment of these taxes, but the estate of the testator.

Exception for Bequests to Spouse

An exception is made with respect to dispositions in favour of the spouse or common-law partner of the deceased. The disposition of property or assets made directly to the spouse of the testator or to a trust created in the testator’s will of the testator for the spouse’s benefit will not result in the recognition of any capital gains or losses on the death of the testator.

An estate planning tool immediately becomes evident as a consequence of this exception; namely, to the extent feasible, assets that have inherent capital gains in them should, to the extent possible, be among those that are bequeathed to the spouse. In doing so, the recognition of those capital gains attaching is deferred until such time as they are disposed of by the surviving spouse.

Appointment of Liquidator

As to Liquidators or Executors, it is often assumed by a testator that naming someone as an Liquidator is to confer an honour on that person. Nothing could be further from the truth! The job of an Liquidator is an onerous task in today’s world and should be left to professionals, with at best one of the heirs involved in the winding-up of the estate who will be able to report back to the other heirs on the progress being made. Some of the Liquidator’s responsibilities even carry personal liability if not properly performed, which is not something that a friend or relative will appreciate.

It is also very important to ensure that the majority of the Liquidators or the sole Liquidator are and remain at all times Canadian residents within the meaning of the income tax laws so as to avoid any possibility of double taxation. If not, there will be one set of taxes payable by the estate of the deceased as a result of his or her death and another set of taxes, commonly referred to as a “departure tax” when the controlling Liquidator moves out of Canada since the estate that he controls is deemed to have also left Canada.

IS THE LEGAL HYPOTHEC AGAINST MY PROPERTY VALID?

Melvin S. Schiff and Aubie J. Herscovitch

The *Civil Code of Quebec* allows architects, engineers, contractors, sub-contractors and suppliers to register legal hypothecs (formerly known as “liens”) on immoveable property to secure payment of amounts due to them with respect to work performed or materials supplied. The legal hypothec constitutes a mortgage on the immoveable and enjoys, in some sense, a “super” status in that the contractor is paid ahead of other secured creditors to the extent of the value added to the immoveable by their work.

The *Building Act* (R.S.Q., c. B-1.1) (a provincial statute) is designed to ensure the proper quality of construction work of buildings as well as the safety of the public who have access thereto. In fulfilling those functions, *The Building **Act*** provides for licensing of contractors and sub -contractors. Section 7 of *The Building Act* defines a "*contractor"* as "*any person who, for another person, carries out or has carried out construction work or draws up or submits tender bids, either directly or indirectly with the purpose of carrying out or having carried out such work for profit"*.

Sections 46 and 50 of the *The Building Act* provide as follows:

Section 46: *No person may act as a building contractor, hold himself outr to be such or give cause to believe that he is a building contractor, unless he **holds a current licence** for that purpose*

*No contractor may use, for the carrying out of construction work, the services of another contractor who **does not hold a licence** for that purpose.*

Section 50: *A person not being a contractor who has entered into a contract for construction work with a contractor not holding the proper licence may apply for cancellation of the contract.*

*The owner of an immoveable charged with a legal hypothec referred to in paragraph 2 of articles 2724 of the Civil Code and registered on the application of a contractor **who does not hold** the proper licence may apply for the cancellation of the registration of the hypothec and for the cancellation of any related registration which the contractor may have applied for.*

No application for the cancellation of a contract or privilege will be granted where it is established that the applicant was aware that the contractor did not hold a proper licence."

On the basis of these provisions, a contractor who does not have a current licence may loose his rights to publish a legal hypothec against the property worked on, notwithstanding that the contractor may have the right to publish under the *Civil Code of Quebec*. In the event at the time the work was performed, the contractor was not properly licensed, the owner of the property may apply for the cancellation of the registration. Moreover, the non-licensed contractor is also exposed to cancellation of his contract by reason of his failure to comply with the licensing provisions of *The Building Act*.

It should be noted that these provisions apply only to contractors and do not affect suppliers or other parties who may otherwise enjoy the right to register a legal hypothec.

Although *The Building Act* entitles the property owner or the party who contracted with the non-licensed contractor to request cancellation of the contract, the Courts have held on the basis of Articles 1699 and following of the *Civil Code of Quebec* that, in such event, each party is obliged to restore to the other that which he has received. In the event work has been performed and is not susceptible of being removed and returned to the non-licensed contractor, the Courts have held that the building owner is obliged to restore to the non-licensed contractor the equivalent value of that which has been supplied. That value has been held to be the value of the work charged by the non-licensed contractor.

It is therefore essential that contractors who fall within the ambit of Section 7 of *The Building Act* ensure that they are properly licensed in order to avail themselves of their rights to register legal hypothecs. Should they lose that right, they may be prejudiced in recovering amounts owing for their work since their only claim will be a personal claim against the party with whom they contracted.

Conversely, a property owner who finds out that a legal hypothec has been published against his property should determine whether in fact the contractor who published the legal hypothec held a valid license under *The Building Act* at the time the work was performed. In the event it is determined that the contractor was not licensed at the time the work was performed, the property owner may apply for the cancellation of the legal hypothec, thereby depriving the contractor of a valuable tool at its disposal.

DO I REQUIRE A TAX FREE SAVINGS ACCOUNT

Gabriel Girouard

What is a tax-free saving account?

Numerous studies show that Canadian households are amassing record levels of debt. To reverse the trend and encourage saving, the federal government introduced the tax-free savings account ("TFSA") in its February 26, 2008 budget.

In some ways, the TFSA mirrors the registered retirement savings plan ("RRSP") and registered education savings plan ("RESP"). As with RRSPs, there is an annual contribution limit, but like RESPs, the contributions are not deductible. Unlike RRSPs, however, the contributions and income that accumulate in a TFSA are not taxable on withdrawal. A TFSA allows you to grow tax-free investment income (i.e., interest, dividends and capital gains) earned on the contributions made using income previously taxed.

Contribution and withdrawal

Commencing in 2009, individuals 18 years and older resident in Canada may contribute a maximum of $5,000 to a TFSA each year. This amount will be indexed as of 2010 and rounded to the nearest $500. Unused contribution room can be carried forward for future years. Accumulated amounts may be withdrawn from the TFSA as needed and at any time. The tax benefit will not be lost if an amount is withdrawn from a TFSA because the individual will gain contribution room equal to the withdrawal. This makes a TFSA much more flexible than an RRSP where the contribution room is lost.

Let's look at an example of how it works (disregarding indexation). If you contribute $2,000 to a TFSA in 2009, your contribution room for 2010 will rise to $8,000 ($5,000 in 2010 and $5,000 minus $2,000 from 2009). A few years later, for example in 2016, you withdraw $35,000 from the TFSA to buy a car. You can then contribute $35,000 to your TFSA because you gain back contribution room equal to the withdrawal without affecting your annual contribution room.

Additional features

Generally speaking, a TFSA is administered in the same manner as an RRSP: an account is opened with an authorized issuer; you must provide your social insurance number. It should be noted noted that loan and interest expenses are non-deductible, etc.
There is no restriction on how withdrawals can be used. Withdrawals may be made for personal reasons, investment, or any other purpose.

As with RRSPs, the money must be invested in qualified investments and there will be penalties for contributions exceeding the annual limit.

Transfer

Individuals may contribute to their own TFSA with funds provided by their spouse without the spouse's annual contribution room being affected. Moreover, the attribution rules will not apply to income earned on those contributions.
On death, the money held in the TFSA of the deceased can be directly transferred to the surviving spouse's TFSA, whether or not the surviving spouse has contribution room and without reducing the surviving spouse's existing contribution room. The amounts accrued in the surviving spouse's TFSA will continue to be tax exempt.
In the case of a marriage or a common-law partnership breakdown, an amount can be directly transferred from one party's TFSA to the ex-spouse's TFSA according to a settlement or a court order without any tax consequence. Although the transferor's contribution room will not be reinstated, the transfer will not be counted against the transferee's contribution room.

Should you contribute to a TFSA?

Because TFSA withdrawals are not included in income, they will not affect eligibility for income-tested benefits or credits such as Old Age Security benefits, the Guaranteed Income Supplement, the Canada Child Tax Benefit, Employment Insurance benefits, the Goods and Services Tax Credit and the Age Credit. This means that even if contributing to a TFSA yields no immediate tax break, unlike an RRSP, the benefit arises when you withdraw money.
Also, because amounts accumulated in a TFSA are not taxable, it may be advantageous to invest in interest-generating investments taxed at the highest rate (maximum tax rate of 48%).

It is strongly recommended to invest in a TFSA, but only after contributing the maximum to an RRSP, which provides an immediate tax break since the contribution is deducted from income. A TFSA should be considered as part of an individual's overall saving strategy, a strategy that includes an RRSP, as well as an RESP if the individual has dependent children.

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