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Blaneys on Business

"One of the offshoots of the crisis that has gripped global financial markets in 2008... has been a world-wide call for stricter, internationally-integrated regulation of financial institutions, products and activities."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial Group, Stanley Kugelmass at 416.593.3943 or skugelmass@blaney.com.

NEW ONTARIO LAW TIGHTENS UP MORTGAGE REGULATION

Diane Brooks

One of the offshoots of the crisis that has gripped global financial markets in 2008, particularly in the context of publicly funded bailouts amounting to trillions of dollars, has been a world-wide call for stricter, internationally-integrated regulation of financial institutions, products and activities.

Coincidentally enough, a new law placing tighter controls on mortgage lending in Ontario came into force last July 1, just weeks before the financial-market landslide started gathering frightening momentum.

The Mortgage Brokerages, Lenders and Administrators Act, 2006 (the "MBLAA") repeals the previous Mortgage Brokers Act. It is designed to improve consumer protection, partly by regulating entities that lend money on the security of real property and that have not been regulated before.

The MBLAA requires businesses and individuals to be licensed under the Act if they carry on any of the following businesses:

- "dealing" in mortgages (which includes soliciting mortgage funds, assessing borrowers and negotiating and arranging mortgages);
- "trading" in mortgages (buying, selling or exchanging mortgages);
- "administrating" mortgages, by collecting payments and remitting them to the mortgage holders; or
- "lending" money in Ontario on the security of real estate.

Under the Act, four types of licences are granted by the Financial Services Commission of Ontario, which regulates mortgage brokers and the new law:

1. **A mortgage brokerage licence,** which allows a business entity (including a sole proprietor) to carry on the business of dealing, trading or acting as a mortgage lender.

2. **A mortgage broker licence,** which is granted to individuals to deal or trade in mortgages on behalf of a brokerage.

3. **A mortgage agent licence,** which is for an individual working under the supervision of a mortgage broker for a brokerage.

4. **A mortgage administrator's licence**, which allows a business entity to administer mortgages.

The Biggest Change

While the MBLAA is intended to improve the regulation of mortgage brokers, the biggest change is the regulation of mortgage lending.

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"...If you are an individual or company that lends money on the security of real estate in Ontario and do not otherwise qualify under an exemption, you must be licensed under the new MBLAA."

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Section 4 (1) of the new Act provides the following definition of mortgage lender:

> "For the purposes of this Act, a person or entity is a mortgage lender in Ontario when he, she or it lends money in Ontario on the security of real property, or holds themselves out as doing so."

Section 4 (2) states no person or entity shall carry on business as a mortgage lender in Ontario unless he, she or it has a brokerage licence or is exempt from the requirement to have such a licence.

Exempt from the requirements to obtain a brokerage licence are financial institutions, including banks, credit unions, caisse populaires, insurance companies licensed under the *Insurance Act*, lending companies registered under the *Loan and Trust Corporations Act* and their directors, officers and employees (the rationale being that they are already sufficiently regulated).

Worthy of note is the fact that bank subsidiaries (separately incorporated leasing divisions, for example) are not exempt. If they wish to engage in mortgage lending, they too will require a brokerage licence, unless another exemption applies.

A person who is lending their own money for investment purposes is not required to be licensed. Other exemptions may apply, including acting through an intermediary who is a licensed mortgage broker or is otherwise exempt from the requirement to be licensed.

The criteria for a mortgage brokerage licence include being a resident Canadian, having errors and omissions insurance and having a principal broker who qualifies as a mortgage broker.

To qualify as a mortgage broker, an individual must have been a licensed mortgage agent for two years and have met such prescribed educational criteria as community college and industry courses. For many, the requirement to have a principal broker may not be practical.

The MBLAA gives the Superintendent of Financial Services several tools to enforce compliance with the Act, including fines of up to $200,000 for a corporation that fails to obtain the required licence, and up to $100,000 for every director or officer of such corporation who authorized or colluded in non-compliance.

Practical Application

If you are an individual or company that lends money on the security of real estate in Ontario and do not otherwise qualify under an exemption, you must be licensed under the new MBLAA. This includes situations in which a collateral mortgage is obtained as an adjunct to another lending product, such as a line of credit.

Obtaining a mortgage brokerage license may not be practical and such companies will likely want to qualify for the exemption that requires such an entity to carry on the mortgage lending business solely through a licensed mortgage brokerage or an entity that is itself exempt (e.g. a financial institution). ■

COURTS TAKING DIM VIEW OF BROAD NON-COMPETE CLAUSES

Sundeep Sandhu

Contract clauses that aim to prevent former employees from soliciting business from the clients of their former employers or from working with or setting up competing enterprises are very popular in an era in which competition for customers is fierce.

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"...courts are making it increasingly clear that they will enforce these kinds of restrictive covenants only if the covenants are appropriate to the specific situations in question..."

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But the courts are making it increasingly clear that they will enforce these kinds of restrictive covenants only if the covenants are appropriate to the specific situations in question and only if their reach is both reasonable and clearly defined.

A non-competition clause is more drastic in nature than a non-solicitation clause in that it restrains a former employee from conducting business with the former employer's clients and customers after the employee has left the business and it attempts to keep the former employee out of the particular type of business all together.

The problem with non-competition clauses is that they can run contrary to the public interest because free and open competition that is unencumbered by restrictive covenants actually benefits society by creating greater choice and encourages employment opportunities for affected employees.

On the other hand, however, the courts are reluctant to restrict the right of individuals to freely enter into contracts, especially when that right has been exercised by knowledgeable persons of equal bargaining power. The courts are also willing to afford reasonable protection to an employer's trade secrets, confidential information and trade connections. As a result of these competing interests, the courts are generally unwilling to enforce overly broad restrictive covenants.

This was the case in the recent decision released by the Ontario Court of Appeal regarding a dispute in *H.L. Staebler Company Limited and Tim James Allan et al.* where the plaintiff, Staebler Company Limited, a large insurance brokerage firm in Waterloo, Ontario, attempted to enforce what the courts ultimately determined was an overly broad restrictive covenant in an employment contract with two of its former employees.

In this case, Tim James Allan and Jeff Kienapple were employed as commercial insurance sales persons by Staebler since 1982 and 1995 respectively. Collectively they had about 200 clients, some of whom were transferred to them by retired sales persons, developed through new business, or constituted part of a book of business that was sold by Kienapple to Staebler.

Due to issues with a change in management at Staebler, both Allan and Kienapple resigned and entered into standard employment agreements with Stevenson & Hunt as commercial sales agents. As a result of soliciting former clients, Allan and Kienapple were able to transfer a total of 100 former clients to S&H. Staebler alleged this breached section 10 of their employment contract. Section 10 was a restrictive covenant which limited, for a period of two years following their resignations, the employees' ability to "conduct business" with clients and customers handled or serviced by them.

The legal principles applicable to this area of law are well established and are set out in the 1978 Supreme Court of Canada decision in *J.G. Collins Insurance Agencies Ltd. v. Elsley.* The basic principle is that a restrictive covenant is enforceable only if it is reasonable between the parties and with reference to the public interest. To determine "reasonableness" there must be an overall assessment of the clause, the agreement within which it is found, and all of the surrounding circumstances. This analysis is driven by the facts and will always depend on the particular circumstances.

In addition, three factors must be considered in this analysis:

1. whether the employer has a proprietary interest that is entitled to protection,

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2. whether the time period or the geographical location that the restrictive covenant covers are too extensive, and

3. whether the restrictive covenant is unenforceable because it is against competition generally and is not limited to prohibiting solicitation of clients of the former employer.

A non-solicitation clause is normally sufficient to protect an employer's proprietary interest and the courts will generally not enforce a non-competition clause if a non-solicitation clause would have provided the employer with adequate protection. The use of a non-competition clause is warranted only in exceptional circumstances. Thus, in conventional employee/employer relationships, a non-solicitation clause (suitable in temporal and spatial limits) is more likely to be judged reasonable than is a non-competition clause. The fact that a restrictive covenant may be enforceable if it had been drafted in narrower terms will not save it because the issue before the court is not whether a valid agreement might have been made but whether the agreement that was made is valid.

In looking at the employment agreement in H.L. Staebler, the court found that although Staebler had a proprietary interest in its book of business (namely containing its clients) that it was entitled to protect, the covenant went well beyond protecting Staebler's trade connections as it had no geographical limitation and no limit on the type of "business" that the former employees were prohibited from conducting.

In addition, there were essentially no exceptional circumstances to warrant the use of the non-competition covenant. The former employees were two of ten sales persons and they did not have an exceptional role in the business in that they (a) were not managers, directors or key employees, (b) did not stand in a fiduciary relationship with Staebler or have any special knowledge of, or influence over, Staebler's business, and (c) although they had a close relationship with clients, this relationship was not exclusive. There was also an imbalance of bargaining power between each of the employees and Staebler when the employment contracts were negotiated. The parties did not negotiate as equals.

Finally, in employment contracts with five other employees, Staebler limited the restrictive covenants to a 50 mile radius around the Waterloo region. Staebler could not explain this differential treatment. The court ultimately concluded that this indicated that Staebler itself viewed the geographic limitation as sufficient to protect its interest.

As a result of all of the foregoing reasons the court did not enforce the restrictive covenants in the Allan and Kienapple employment agreements.

The basic message in all of this is that if they are going to be enforceable, restrictive covenants must be drafted with great care and specificity and must reflect not only the interests of the workplace parties but the public interest as well. ■

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