Fiduciary Duties of Departing Employees

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INTRODUCTION . . . 2

I. THE FIDUCIARY CONCEPT . . . 3

II. EMPLOYEES AS FIDUCIARIES . . . 6

III. WHICH EMPLOYEES ARE FIDUCIARIES? . . . 8

IV. CONTENT OF THE DUTY . . . 9

V. PUBLIC V. PRIVATE INTEREST . . . 11

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There are few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship.[1]

The employer-employee relationship is perhaps the most regulated and scrutinized of all human relations. The multiplicity of statutes which bear upon this relationship (both at the federal and provincial levels), the common law framework within which the relationship subsides, together with express contractual terms to which the parties may agree, renders the precise nature of this relationship difficult to characterize.

The employment relationship is not purely contractual, as statutory requirements create certain rights and obligations of the parties despite or notwithstanding the existence of agreement to the contrary.[2]

Obviously, this relationship is not governed exclusively by statute, as the common law principles of master and servant have given rise to a well developed body of jurisprudence, particularly in the area of wrongful dismissal.[3]

Similarly, express terms and conditions of employment (and the respective rights of parties subsequent to employment) may impinge on common law principles and thus be unenforceable. This is so particularly in the area of restrictive covenants.[4]

Despite the difficulties in characterizing this relationship, the prevailing view in Canada is that the employment relationship arises out of and is based upon the contract.[5]

The concept of a fiduciary, which will be outlined herein, does not depend upon or necessarily arise from the existence of a contractual relationship. It is therefore important to distinguish the nature of fiduciary obligations from the contractual in order to appropriately analyze the origin of such obligations, their extent and how they may be enforced in an employment or post-employment context.

This paper will briefly examine the fiduciary concept and discuss the application of such concept to the employment relationship. It will then outline the applicable tests for determining which employees are subject to such duties and obligations and will compare such obligations with those owed by employees generally. Finally, it will briefly discuss the desirability of the imposition of fiduciary concepts to post-employment competition in light of the basic contractual nature of the relationship and broader issues of public policy.

I. THE FIDUCIARY CONCEPT

The Supreme Court of Canada has had several occasions in recent years to discuss the fiduciary concept and the circumstances under which a fiduciary relationship may arise. The most recent of these was in *Lac Minerals Ltd.* v. *International Corona Resources Ltd.*[6] where both La Forest, J. for the majority and Sopinka, J. in dissent, extensively canvassed the matter. While both recognized that the fiduciary concept is surrounded with lack of precision and uncertainty, the Court did adopt several principles which are useful starting points for analysis.

First, it was recognized that certain relationships because of their inherent purpose or presumed factual or legal incidents, would give rise to a fiduciary obligation upon a party to act or refrain from acting in a certain way.[7] Some relationships which are generally recognized to give rise to fiduciary obligations would include: director-corporation, trustee-beneficiary, solicitor-client, partners, principal agent and the like. These categories of relationships giving rise to fiduciary duties are not closed nor do the traditional relationships invariably give rise to fiduciary obligations.[8]

Because the courts have refused to define with precision all of those relationships which would give rise to fiduciary obligations, a useful tool for determining whether a particular relationship is one in which fiduciary obligations arise is the following three-fold test suggested by Wilson, J. in *Frame* v. *Smith* for determining whether a person holds a fiduciary position:[9]

(i) the fiduciary has scope for the exercise of some discretion or power;

(ii) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and

(iii) the beneficiary is particularly vulnerable to or at the mercy of the person holding the discretion or power.[10]

The Court recognized that the imposition of fiduciary obligations is not limited to those relationships in which a presumption of such an obligation arises, but that it may arise as a matter of fact out of the specific circumstances of the relationship.[11] As will be seen, this notion is of particular significance in the employment context where it is virtually impossible to categorize the multiplicity of arrangements which parties may make.

The Court also recognized that the fiduciary obligations may vary in their specific substance, depending on the nature of the particular relationship, although it was generally described as a "fiduciary duty of loyalty and will most often include the avoidance of a conflict of interest and a duty not to profit at the expense of the beneficiary."[12]

While the foregoing principles arose in the context of an arms'-length commercial relationship, they are useful in outlining the overriding principles which the Court has recognized as appropriate in analyzing whether a particular relationship is one which gives rise to fiduciary obligations. This is particularly so with respect to those relationships in which fiduciary obligations would not normally be expected.

In this regard, the Court has made it clear that the existence of a fiduciary obligation can be said to be a question of fact to be determined by examining the specific facts and circumstances

surrounding each relationship[13] and the consideration of such factors as whether the relationship involved elements of trust and confidence, the context in which the relationship was found, the practice of the particular industry, and the question of the vulnerability of one of the parties to the relationship to harm or injury. Virtually all of these factors have previously been considered by lower Courts in considering whether particular employment relationships gave rise to fiduciary obligations, although perhaps without the doctrinal guidance which has now been provided by the Supreme Court.[14]

II. EMPLOYEES AS FIDUCIARIES

The employment relationship is one of the recognized relationships from which fiduciary obligations may arise, both during and after the currency of employment.

The starting point for any analysis of Canadian law on this issue is the decision of the Supreme Court of Canada in *Canadian Aero Service Ltd.* v. *O'Malley*.[15] In that case certain senior officers of the plaintiff company usurped for themselves a business opportunity to which they had devoted effort and planning while they had been employed by the company.

The first issue which is required to be determined by the Court was whether the status of the defendants as senior officers gave rise to fiduciary obligations on their part. After stating that it did not matter that certain of the defendants were not directors of the company, Laskin, J. stated:

They were 'top management' and not mere employees whose duty to their employer, unless enlarged by a contract, consisted of only respect for trade secrets and for confidentiality of customer lists. Theirs was a larger, more exacting duty which, unless modified by statute or by contract (and there is nothing of this sort here) was similar to that owed to a corporate employer by its directors.[16]

Laskin, J. went on to outline the nature and extent of the fiduciary duties owed by an employee or former employee to their employer:

The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officers' relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time and the continuation of the fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances on which the relationship was terminated, that is whether by retirement or resignation or discharge.[17]

The policy grounds upon which the Court founded its decision were expressed in the following terms:

It is a necessary supplement, in the public interest, of statutory regulation and accountability which themselves are, at one and the same time, an acknowledgement of the importance of the corporation in the life of the community and the need to compel obedience by it and by its promoters, directors and managers to norms of exemplary behaviour.

While it is difficult to disagree with the result in the *Canadian Aero* case, where the Court essentially precluded the theft of an asset of the plaintiff company, there is less consensus on the extension and elaboration of the fiduciary duties of employees in subsequent case law, particularly as they relate to the notion of post-employment competition.[18] It has also been observed that traditional reluctance of the courts to impose fiduciary obligations in a contractual context has diminished in recent years:

While the law has not been hesitant to recognize the duty of good faith and loyalty on the part of an employee toward the employer, it has been hesitant to equate that duty, as in a fiduciary situation, to one that is essentially trustee in nature. However, it may be fairly said that that reticence is evaporating in the modern commercial context.[19]

III. WHICH EMPLOYEES ARE FIDUCIARIES?

The *Canadian Aero* decision established that senior officers or "top management" owed a fiduciary duty to their employer analogous to that owed by corporate directors. Employees in such positions were distinguished from "mere employees" who, although obliged to refrain from utilizing customer lists and other similar information, are not subject to the more exacting obligations of a fiduciary.[20]

In *Alberts* v. *Mountjoy,*[21] one of the principal cases to follow *Canadian Aero*, Estey C.J.H.C. considered whether the defendant, who had been the general manager of the plaintiff's insurance agency, held a senior position which would attract fiduciary obligations. In concluding that he did fall into this category, Estey C.J.H.C. performed a careful analysis of Mountjoy's position with the plaintiff's organization, his day-to-day functioning and determined that he was the "directing force" of the company. Interestingly, he also found that a co-defendant salesman, who would not independently be subject to a fiduciary duty, was bound by the same duties as Mountjoy as a result of having joined him in the new enterprise.[22]

The Manitoba Court of Appeal in *W. J. Christie Co.* v. *Greer*[23] expressed the nature of the position liable to attract such fiduciary duties as "a director/officer/key management person who occupies a fiduciary position." The adoption of this test is seen to have expanded the categories of individuals subject to fiduciary obligations. Ellis, in *Fiduciary Duties in Canada*, observes:

The substantive test of 'top management' has been considerably widened by the adoption of a test aptly described as 'key personnel'. The difference, functionally, between an individual who occupies "top management" and one who fits the designation "key personnel" is self evident. Although function remains the salient factor, "key" may be interchanged with "essential" - the description available at all levels of employment - where as "top

> *management" can only be interpreted to relate to the control and authority aspect of the position.*[24]

The Alberta Court of Queen's Bench recently elaborated upon the criteria to be utilized in determining whether an individual is a key employee, holding that such is a person that has power and control over his or her employer and has the capability of making the employer vulnerable through his actions. If this definition is met, then there is a fiduciary obligation not to misuse such power to the detriment of the employer without justification.[25]

While, as noted, mere employees will owe certain obligations to their employer, the more exacting obligations of fiduciary will be imposed upon those individuals who are seen to be key to the operations of their former employer. This determination requires a detailed functional analysis of the facts of the particular case. While this may have the effect of creating uncertainty and "discourage any employee from assuming light heartedly that it would be in his best interest to compete freely with his employer",[26] it is consistent with the analytic approach adopted by the Supreme Court in *Lac Minerals* described above, in that it requires a detailed analysis of the essential characteristics of the particular relationship in order to determine whether fiduciary obligations arise therefrom.

IV. CONTENT OF THE DUTY

The public interest in prescribing conduct as egregious as that demonstrated by the defendants in *Canadian Aero* is not difficult to discern. Nor is the rationale for the basic common law obligations of fidelity and good faith on the part of employees which require "respect for trade secrets and for confidentiality of customer lists".[27] The question of whether an employee has appropriated for their own use a business opportunity or advance belonging to the employer will largely be determined by the facts of the particular situation and the nature of the particular opportunity. An example of the type of analysis which will be conducted in such a situation is found in *Re Berkey Photo (Canada) Ltd.* v. *Ohlig* where it was noted:

> *For competition by a former employee to be a breach of fiduciary duty where there is not misuse of confidential information, there must be acts committed before the cessation of employment which formed at least a part of the wrongful conduct complained of. There must also be a acquisition of a business opportunity or advantage which was available to the employer and not readily available to the employer's competition. An example is a fresh corporate opportunity which has developed to the point where it is about to ripen. In that situation, if the employee quits so as to pick the fruit of the opportunity personally, his conduct is improper and gives rise to liability.*[28]

A more difficult task is to reconcile the various expressions of the factors relevant in determining whether certain less dramatic conduct (such as simply doing business with the customers of the former employer) may constitute a breach of fiduciary obligations for which a former employee may be held liable.

In *Alberts* v. *Mountjoy* the traditional view of the rights of individuals to compete against their former employers was recognized as follows:

> *It is now beyond argument that a departing servant has the right to compete with his former employer. He may do so by establishing a business in direct or partial competition and he may bring to that business a knowledge and skill which he acquired while in the former service, including knowledge and skill directly obtained from the previous master in teaching him his business.*[29]

However, after canvassing the limitations on the extent to which an employee may make use of such knowledge, Estey C.J.H.C. concluded that the right of a former employer to compete was not unlimited but was circumscribed by a notion of fairness:

> *Thus we have a principle within a principle to the effect that an ex-employee is not entitled to make 'an unfair use' of information acquired in the course of his employment, nor may he use confidential information so acquired to advance his own business at the expense of that of his former employer.*[30]

In the result it was held that Mountjoy was in breach of his fiduciary obligations to his former employer by diverting certain of the plaintiff's insurance renewal business to a new operation. While this activity was somewhat analogous to the appropriation of a corporate opportunity, perhaps the most basic obligation is not to directly solicit the clients or customers of

the former employer. This duty has been described as simply "an amplification of the basic duty to act honestly and in good faith."[31]

The content of the duty not to compete, including temporal aspects, was outlined by Saunders, J. in *Wallace Welding Supplies Ltd.* v. *Wallace*:

> *The duty is not to act unfairly toward the former employer. More specifically it includes a requirement that for a reasonable period of time, the former employee in competing with his former employer, as he has the right to do, must not exercise an advantage that he may have by virtue of his former employment.*[32]

V. PUBLIC V. PRIVATE INTEREST

While it is obvious that the enforcement of fiduciary duties in the employment (where it may give rise to cause for dismissal) or post-employment context will involve the consideration of private rights and interests, as noted above the ostensible basis expressed by Laskin J. in *Canadian Aero* for the imposition of fiduciary duties is the public interest in maintaining "norms of exemplary behaviour".

To place the matter in context, it is important to recognize the view of the public interest expressed by the Supreme Court of Canada in considering whether to enforce post-employment restrictive covenants. Those principles were summarized as follows:

> *A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest. As with many of the cases which come before the Courts, 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.*[33]

Against this background, the fiduciary concept has developed to the point of proscribing "unfair" competition on the part of former employees. This may be contrasted with the question of whether restrictions on post-employment competition are "reasonable". In fact, it may be observed in a number of cases that the notion of a fiduciary duty not to compete is frequently used to "backstop" or provide an alternative to a claim founded upon the alleged breach of a restrictive covenant[34] which is liable to be found unenforceable. This raises the obvious question of why it is necessary to imply obligations as between the parties in addition to those contractual terms to which they have agreed.

Surely, if the fiduciary relationship is analyzed in the manner suggested by the Supreme Court of Canada, and the parties have addressed, on a contractual basis, their respective rights and obligations after the relationship has terminated, there is little room to imply additional duties and responsibilities.

Similarly, if the vulnerability of a party is one of the most important determining factors in ascertaining the existence of a fiduciary relationship, the very fact of such vulnerability would appear to mandate attention to the matter by the parties when defining their relationship. This is particularly so where, unlike the beneficiary of a trust, an employer is in a position to influence the extent of its vulnerability and to insist on contractual protection.

While it is desirable that the courts retain a supervisory role of the contractual arrangements of parties in the employment contract and refuse to uphold such arrangements where the result would lead to injustice[35] or be contrary to expressed public policy, it is submitted that the contractual analysis of the fiduciary concept recently outlined by the Supreme Court of Canada should lead to a basic review of the applicability of the concept to the employment or post-employment contract in light of the essentially contractual nature of that relationship and the desirability of parties defining such relationships for themselves.

FOOTNOTES

1. *Lac Minerals Ltd.* v. *International Corona Resources Ltd.,* [1989] 2 S.C.R. 574 at 643, La Forest J.

2. See for example section 4(1) of the *Employment Standards Act,* R.S.N.B. 1973 c. E-7.1 for a provision typically found in Canadian minimum employment standards legislation in this regard.

3. See D. Harris, *Wrongful Dismissal* (Toronto: DeBoo, 1989).

4. This area is to be canvassed in a paper by Charles Hackland presented to these proceedings and will not be elaborated upon in detail herein.

5. Christie, *Employment Law in Canada* (Toronto: Butterworths, 1980) at 12-13.

6. *Lac Minerals* v. *International Corona Resources Ltd., supra, note 1.*

7. *Ibid.* at 646, La Forest, J.

8. *Ibid*. at 597, Sopinka, J.

9. *Frame* v. *Smith,* [1987] 2 S.C.R. 99.

10. Adopted by La Forest, J. in *Lac Minerals, supra* note 1 as a "useful tool" at 647.

11. *Supra* note 1 at 648, La Forest J.

12. *Ibid*. at 646.

13. *Ibid*. at 648.

14. See M.V. Ellis, *Fiduciary Duties in Canada* (Toronto: DeBoo, 1988) at 16-27 for a catalogue of cases indicating the position held, the nature of the impugned activity and the disposition.

15. *Canadian Aero Service Ltd.* v. *O'Malley* [1974] S.C.R. 592 [hereinafter *Canadian Aero*].

16. *Ibid.* at 606.

17. *Ibid.* at 620.

18. P. Downard, "Post-Employment Competition and the Courts: An Unfortunate Curve in the Common Law" (1985) 6 Advocates' Q. 361.

19. *Supra* note 14 at 16-17.

20. For discussion as to whether the duty of good faith is essentially a fiduciary obligation, see *Alnor Services Ltd.* v. *Sawyer* (1990), 31 C.C.E.L. 34 (B.C.S.C.) at 62-63.

21. *Alberts* v. *Mountjoy* (1977), 79 D.L.R. (3d) 108 (O.H.C.J.).

22. *Ibid.* at 116.

23. *W. J. Christie Co.* v. *Greer* (1981), 121 D.L.R. (3d) 472.

24. M. V. Ellis, *supra* note 14 at 16-17.

25. [1991] A.J. No. 686.

26. Atkinson & Spence, "Fiduciary Duties Owed by Departing Employees - The Emerging Unfairness Principle" (1984) 8 Can. Bus. L.J. 501 at 510.

27. *Supra* note 15, at 606.

28. (1983), 43 O.R. (2d) 518 at 531-532 (H.C.J.).

29. *Supra* note 21 at 112.

30. *Ibid.* at 115.

31. Colombo, "Confidential Information and Property Rights: A Study of Employment Contracts" (1989) 3 Nat'l Labour Rev. 20 at 28.

32. *Wallace Welding Supplies Ltd.* v. *Wallace* (1986), 8 C.P.C. (2d) 157 at 164.

33. *Elsley* v. *J.G. Collins Ins. Agencies Limited,* [1978] 2 S.C.R. 916 at 923.

34. See for example *East Coast Lumber Ltd.* v. *Robert McLean* (1984), 53 N.B.R. (2d) 137 (N.B.Q.B.) and *Gerard* v. *Century 21 Armour Real Estate Inc.* (1981), 35 C.C.E.L. 128.

35. Such as where a notice provision in an employment contract is not enforced. See *supra* note 3 at 9-11 for a discussion of this issue.