

# CONFIDENTIALITY, INTELLECTUAL PROPERTY AND COMPETITIVE RISK IN THE EMPLOYMENT RELATIONSHIP

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*This article gives an overview of the key issues in the employment relationship relating to confidentiality, intellectual property and competition by an employee with a present or former employer. It considers matters chronologically, dealing first with the establishment of the employment relationship and then with the issues faced on the employee's departure.*

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*L'article propose un survol des questions clés soulevés en matière de relation d'emploi quant à la confidentialité, la propriété intellectuelle et la concurrence d'un employé avec l'employeur actuel ou avec un ancien employeur. Le texte considère les questions de façon chronologique, abordant d'abord l'établissement de la relation d'emploi puis les questions relatives au départ de l'employé.*

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### *I. Introduction*

Information and intellectual property are becoming increasingly valuable assets to a greater number and diversity of businesses. The increasing mobility of labour in the new economy creates significant challenges for businesses in protecting these assets.

Businesses should be aware of their rights and obligations under the employment relationship. This paper takes a practical view of these rights and obligations, focusing on the actions that businesses need to take to protect themselves.

In this essay, we take a chronological approach to examining employers' rights and the measures they can take to protect them. We begin by examining what rules will apply in the absence of a written employment agreement. We then examine a number of measures that employers can take to protect themselves in establishing the employment relationship. Finally, we examine the issues associated with departing employees, outlining protective measures that can be taken, and the legal remedies available where the employer's rights have been breached.

### *II. The Employee's Rights and Obligations in the Absence of a Written Agreement*

Employees have a number of key duties and obligations in the employment relationship.<sup>1</sup> An employee has a duty to render personal

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<sup>1</sup> *Simmons v. Hoover Ltd.*, [1977] Q.B. 284.

service. As such, an employee must be ready and willing to work. An employee also has an obligation to obey reasonable orders and carry out reasonable instructions.<sup>2</sup> Moreover, an employee is under a duty to take reasonable care in the performance of his or her duties. An employee also promises that he or she is reasonably competent to perform the job that he or she has been hired for.<sup>3</sup> A duty to act honestly and with integrity also forms part of the employment relationship.<sup>4</sup> This means that an employee must be forthright with the employer, not make untruthful statements to representatives of the employer, and not be deceitful. An employee also has a duty to protect the employer's interests and reputation.<sup>5</sup> As such, an employee must not deliberately or negligently harm the employer's business or reputation. An essential duty of the employment relationship, and the focus of this paper, is the duty of fidelity.<sup>6</sup>

### A. The Implied Duty of Fidelity

In any employment relationship, the employee is subject to the duty of fidelity. The duty of fidelity is an implied term in every employment contract and is often augmented by express provisions in the employment agreement. This duty is owed throughout the course of employment, and certain elements of it survive the termination of the employment relationship. This duty includes the following three significant obligations:

1. a duty not to compete with the employer's business;
2. a duty to maintain the employer's information in confidence; and
3. a duty to disclose to the employer relevant information developed or learned during the employment relationship.<sup>7</sup>

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<sup>2</sup> *Dick v. The Canada Jute Co.* (1886), 30 L.C.J. 185 (S.C.), and *Relihan c. Bell Canada*, J.E. 82-1005 (C.S.).

<sup>3</sup> *Prescott v. Adams* (1906), 38 S.C.R. 365.

<sup>4</sup> *Lake Ontario Portland Cement Co. v. Groner*, [1961] S.C.R. 553.

<sup>5</sup> *MacLellan v. Line Canada Machine-Outil Ltee*, D.T.E. 83T-540 (Sup. Ct.) and *Chamberlain v. Maisonneuve Broadcasting Co.*, D.T.E. 87T-669 (Sup. Ct.).

<sup>6</sup> *Positron Inc. v. Desroches*, [1988] R.J.Q. 1636 (C.S.) and *Hivac Ltd. v. Park Royal Scientific Instruments Ltd.*, [1946] 1 Ch. 169 (C.A.).

<sup>7</sup> Richard A. Brait, "Confidentiality in the Employment Relationship" (1990) 5 I.P.J. 187 at 188. The duty of fidelity also encompasses: a duty to provide full time service to the employer (*Atlas Janitorial Services Co. v. Germanis* (1994), 53 C.P.R. (3d) 1 (Ont. Gen.Div.)); the obligation not to make a secret profit (*E.M. Plastic & Electric Product Ltd. v. Hobza* (1992), 43 C.P.R. (3d) 74 (Ont. Gen. Div.), var'd (1993), 52 C.P.R. (3d) 166 (Ont. C.A.)); and the obligation of the employee when off duty not to engage in activities that conflict with the best interests of the employer (*Canadian*

These duties are discussed below.

### *1. Non-Competition*

During employment, the duty of non-competition is strict. The relevant components of the employee's duty not to compete with the business of his or her employer are:

1. the duty not to intercept corporate opportunities, including customer connections; and
2. the duty not to engage in other work that may conflict with or damage the employer's business.<sup>8</sup>

The first component - intercepting corporate opportunities for the employee's own benefit during the course of employment - clearly offends the duty not to compete. But the second component may be harder to judge.

Whether other work will constitute a breach of duty depends on the risk of conflict of interest with, or damage to, the employer's business. This includes the risk that the employer's confidential information will be disclosed.<sup>9</sup> Various factors are relevant to this determination, including the degree to which the other work interferes with the employer's business, the nature of the employment (including the extent of competition in the field), whether the employee is acting dishonestly, and whether the employer expressly prohibited outside work.<sup>10</sup> Divulging confidential information will not necessarily provide "cause" for dismissal where no reasonable possibility of harm to the employer and other mitigating circumstances exist.<sup>11</sup>

On termination of the relationship, the duty not to compete largely disappears. The ex-employee may work for a competitor and may compete directly with his or her former employer. However, this freedom to compete is not absolute, as will be discussed in more detail below. First, an employee that is in a fiduciary relationship with the former employer continues to owe certain duties after employment is terminated. Second, an employee must not misuse the employer's

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*Imperial Bank of Commerce v. Boisvert*, [1986] 2 F.C. 431 (C.A.).

<sup>8</sup> Geoffrey England, Innis Christie and Roderick Wood, *Employment Law in Canada*, 3rd ed., looseleaf (Markham: Butterworths, 1998) [England and Christie] at para. 11.130.

<sup>9</sup> Brait, *supra* note 7 at 189.

<sup>10</sup> *Segin v. Hewitt* (1993), 1 C.C.E.L. (2d) 5 (Ont. Gen. Div.).

<sup>11</sup> *Warnes v. Army & Navy Dept. Stores Ltd.* (1996), 22 C.C.E.L. (2d) 11 (Sask. Q.B.).

confidential information. Finally, the employee's competition must not be unfair.<sup>12</sup>

This last restraint on an employee's freedom to compete overlaps somewhat with the restraint against the misuse of confidential information, since such misuse will often import the necessary level of unfairness into the employee's competitive activities. The requirement of fairness also blurs the already ill-defined line between regular employees and fiduciary employees and renders the law somewhat uncertain in this regard.<sup>13</sup> The discussions of confidentiality and fiduciary relationships below outline some of the obligations that will be imposed under this requirement.

## 2. Confidentiality

Unlike the duty of non-competition, the duty to maintain the employer's information in confidence survives the termination of the employment relationship for fiduciary and non-fiduciary employees alike. During and after the employment relationship, the employee must keep confidential, and refrain from using otherwise than for the employer's benefit, the confidential information and trade secrets that the employer communicated or that the employee obtained through his or her employment.<sup>14</sup> Confidential information can relate either to the conduct of a business, including its structure, the identity of its suppliers, pricing, marketing techniques, and customer lists, or to the products of the business, including its trade secrets, formulas, and manufacturing processes.

In Canada, there is no statutory definition of "confidential information". It is therefore necessary to look to the common law. There are four essential elements that identify information as confidential. First, there is value to the owner through it being secret. In *International Corona Resources Ltd. v. Lac Minerals Ltd.*,<sup>15</sup> the Ontario Court of Appeal held that information that is partly private and partly public was confidential where the plaintiff's assistance in acquiring and developing the information resulted in the enhanced

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<sup>12</sup> See, e.g., *Sure-Grip Fasteners Ltd. v. Allgrade Bolt & Chain Inc.* (1993), 45 C.C.E.L. 276 (Ont. Gen. Div.).

<sup>13</sup> England, Christie and Wood, *supra* note 8 at para. 11.137.

<sup>14</sup> *Amber Size & Chemical Co. Ltd. v. Menzel*, [1913] 2 Ch. 239, approved in *International Tools Ltd. v. Kollar et al.*, [1968] 1 O.R. 669 (C.A.).

<sup>15</sup> (1987), 62 O.R. (2d) 1 (C.A.). The Supreme Court of Canada in [1989] 2 S.C.R. 574, implicitly acknowledged the value of the confidential information obtained by the plaintiff as: "it put Lac in a preferred position vis-à-vis others with respect to knowledge of acquiring the Williams property." See also *Schauenburg Industries v. Borowski* (1979), 25 O.R. (2d) 737 (H.C.J.).

value of that information. The amount of effort or money expended in obtaining and developing the information and the fact that the information has acquired commercial value are important factors in determining whether the information is confidential.<sup>16</sup> In *Drake International Inc. v. Tennenbaum et al.*, the court held that the information in question was confidential on the basis that it was “a valuable trade asset of the plaintiff which is deserving of protection”.<sup>17</sup>

Second, the information is relatively secret. The information must not be common knowledge and the owner of the information must “limit the dissemination of it or at least not encourage or permit widespread publication”.<sup>18</sup> In *Saltman Engineering Co. Ltd. v. Campbell Engineering Co. Ltd.*,<sup>19</sup> the court held that to be considered confidential, information must have the necessary quality of confidence about it, namely, it must not be something which is public property and public knowledge.

In several cases, it has also been suggested that “the usage and practices of the particular industry or trade concerned” can serve as a guide to the inaccessibility of information which is claimed to be confidential.<sup>20</sup>

Third, reasonable measures have been put in place to protect the information. The leading case is *R.I. Crain Limited v. Ashton Press Manufacturing Company Limited*,<sup>21</sup> where the trial judge dismissed the plaintiff’s action and held that the information in question, which was originally secret, could no longer be considered confidential on the basis that it had been widely disseminated to others. In the Ontario Court of Appeal decision in *International Tools Ltd. v. Kollar*,<sup>22</sup> employees were given limited access to a specific area marked with signs prohibiting entry. The court prevented the recipients from making use of or disclosing the information that they had acquired on the basis that:

A high degree of secrecy was maintained in connection with the pin-making; it was done in a locked area to which the only access was through the office of a managerial employee and to the door of which only two keys were in existence;

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<sup>16</sup> *Lange Canada v. Platt* (1972), 9 C.P.R. (2d) 231 at 236 (Qc.Q.B.) and *Creditel of Canada Ltd. v. Faultless* (1977), 36 C.P.R. (2d) 88 (Ont. H.C.).

<sup>17</sup> (1986), 10 C.P.R. (3d) 119 at 121 (Ont. H.C.J.).

<sup>18</sup> *Lansing Linde Ltd. v. Kerr*, [1991] 1 All E.R. 418 (C.A.).

<sup>19</sup> [1963] 3 All E.R. 413 (C.A.).

<sup>20</sup> *Thomas Marshall (Exports) Ltd. v. Guinle*, [1978] 3 W.L.R. 116 (Ch.D.).

<sup>21</sup> [1949] O.R. 303 (S.C.), aff’d [1950] 1 D.L.R. 601 (Ont. C.A.).

<sup>22</sup> *Supra* note 14.

[there were] “No Admission” signs on the door, and masking of the glass partition to prevent observation from outside of what was going on inside...<sup>23</sup>

Fourth, the information is original, identifiable and concrete. The information must be ‘more than common knowledge.’<sup>24</sup> The court in *Fraser et. al v. Thames Television Ltd. et al.*<sup>25</sup> held that:

...the plaintiff must establish not only that the occasion of communication was confidential, but also that the content of the idea was clearly identifiable, original, of potential commercial attractiveness and capable of being realized in actuality.<sup>26</sup>

In *Promotivate International Inc. v. Toronto Star Newspapers Ltd.*,<sup>27</sup> an idea for a newspaper contest was found to lack the necessary originality and concreteness:

The concept was very well-known and I cannot accept that the idea of applying the concept to a newspaper lottery warrants the protection of the court. It was this sort of concept that could be and was applied to any type of lottery where there was to be more than one winner.<sup>28</sup>

The Supreme Court of Canada in *Cadbury Schweppes Inc. v. FBI Foods Ltd.*,<sup>29</sup> found that the information in that case was confidential in nature since it was inaccessible and could be traced to a particular source.

In *Faccenda Chicken Ltd. v. Fowler*,<sup>30</sup> the court held that an important factor was whether the relevant information could be easily separated from other information which an individual was free to use and disclose. The court denied protection in this case and observed that the relevant sales information contained some material which Faccenda Chicken Ltd. conceded was not confidential if looked at in isolation and that the information about the prices was not clearly severable from the

<sup>23</sup> *Ibid.* at p. 672.

<sup>24</sup> *Cradle Pictures (Canada) v. Penner* (1977), 34 C.P.R. (2d) 34 at 47.

<sup>25</sup> [1983] 2 All E.R. 101 (QB).

<sup>26</sup> *Ibid.* at p. 122.

<sup>27</sup> (1985), 23 D.L.R. (4<sup>th</sup>) 196 (Ont. H.C.J.).

<sup>28</sup> *Ibid.* at 200.

<sup>29</sup> [1999] 1 S.C.R. 142. In *Terrapin Ltd. v. Builders Supply Co. (Hayes) Ltd.*, [1967] R.P.C. 375 (Eng. Ch.), Huddart J. quoted Roxburgh J. who stated that information:

[must also be] something that can be traced to a particular source and not something which has become so completely merged in the mind of the person informed that it is impossible to say from what precise quarter he derived the information which led to the knowledge which he is found to possess.

<sup>30</sup> [1986] 1 All E.R. 617 (C.A.) [*Faccenda Chicken*].

rest of the sales information.<sup>31</sup>

Under Canadian law, the test to determine whether the information is objectively novel and concrete is the “reasonable person test”.<sup>32</sup> The test is whether a reasonable person would, in the circumstances, have known that the relevant information was confidential based upon its “obvious character”.<sup>33</sup> A subjective element was added to the test in *Thomas Marshall (Exports) Ltd. v. Guinle*,<sup>34</sup> where the court found that information should be protected where the owner of the information reasonably believes that the information is not in the public domain.

In the United States, confidential information in a business context is covered by the term “trade secret”. Under the *United States Uniform Trade Secrets Act*, which has been adopted by most states, “trade secret” means:

Information, including a formula, pattern, compilation, program, device, method, technique or process that: (i) derives independent economic value, actual or potential, from not being generally known, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.<sup>35</sup>

The legislation in several states includes additional factors to be used to determine whether given information is a trade secret, such as: the savings effected and value to the holder in having the information as against competitors;<sup>36</sup> the amount of effort or money expended in obtaining and developing the information;<sup>37</sup> and the ease or difficulty with which similar information could be properly acquired or duplicated by others.<sup>38</sup>

After termination of employment an employee is not prevented

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<sup>31</sup> See also *Reed Stenhouse Ltd. v. Foster* (1989), 27 C.P.R. (3d) 419 (Alta. Q.B.).

<sup>32</sup> *Printers & Finishers Ltd. v. Holloway*, [1964] 3 All E.R. 731 (Ch.D.).

<sup>33</sup> *Ken Graham Consumer Products Ltd. v. Sunbeam Corp (Canada) Ltd* (1989), 25 C.P.R. (3d) 52 at 76-77 (Ont. H.C.J.) and *Eaton Fund Distributors v. Poulin* (1973), 12 C.P.R. (2d) 35 (Ont. H.C.J.).

<sup>34</sup> *Supra* note 20 at p. 136.

<sup>35</sup> See *Uniform Trade Secrets Act*, section 1 “Definitions”. Although the definition appears to have been meant to cover business as well as technical information, this is not completely clear from the language used and some states have altered the definition to clarify this point. Colo. Rev. Stat. Art. 74, s. 7-74-102, Conn. Stat. Ann. Title 35, Chap. 625, s. 35-51, N.C. Gen. Stat., s. 66-152.

<sup>36</sup> Colorado and Tennessee.

<sup>37</sup> Connecticut, Illinois, Tennessee.

<sup>38</sup> Ohio, Maryland, Colorado, Illinois, Tennessee.

from using for his or her own benefit or for the benefit of a new employer (including the former employer's competitors), his or her own "business or professional skill, although that skill was acquired while he was in the service of his former master."<sup>39</sup> In addition, there are some items of confidential information which will be protected during employment but not afterwards. The English Court of Appeal in *Faccenda Chicken* discusses this information as follows:

It is clear that the obligation not to use or disclose information may cover secret processes of manufacture...[or] other information which is of a sufficiently high degree of confidentiality as to amount to a trade secret. The obligation does not extend, however, to cover all information which is given to or acquired by the employee while in his employment and in particular may not cover information which is only "confidential" in the sense that an unauthorized disclosure of such information to a third party while the employment subsisted would be a clear breach of the duty of good faith.<sup>40</sup>

Distinguishing between protectible and unprotectible items can be difficult. For example, while it is clear that an employee is forbidden from removing and using in competition with the employer a written customer list, it is not clear that an employee is prohibited from using information about customers that he or she has come to know through day-to-day exposure to the information during his or her employment.<sup>41</sup>

The courts have also recognized a category of information called "know-how" which an employee is entitled to use after his employment, but whose use can be restrained by the use of a properly drafted written employment agreement. This is discussed in more detail later in this paper.<sup>42</sup>

Another restriction on employees' use of information involves information that has come into the public domain. Despite information

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<sup>39</sup> *Routh v. Jones* (1946), [1947] 1 All E.R. 179 (Ch. D.) at 181, aff'd [1947] 1 All E.R. 758 (C.A.); see also the older authority of *Herbert Morris Ltd. v. Saxelby*, [1916] 1 A.C. 688 (H.L.). Recent examples include *Farm Business Consultants Inc. v. Kindret* (2002), 164 Man. R. (2d) 224 (Q.B.) and *IT/NET Ottawa v. Berthiaume*, [2002] O.T.C. 859 (S.C.).

<sup>40</sup> *Supra* note 30 at 625.

<sup>41</sup> As noted in England and Christie, *supra* note 8, a variety of answers have been given to this question, and the law remains somewhat unclear. See, for example, *Scantron Corp. v. Bruce* (1996), 20 C.C.E.L. (2d) 260 (Ont. Gen. Div.) (names and numbers learned through on-the-job exposure can be used); *Barton Insurance Brokers Ltd. v. Irwin* (1999), 40 C.C.E.L. (2d) 159 (B.C.C.A.) (lists purposefully memorized may be used); but *c.f. Quantum Management Services Ltd. v. Hann* (1989), 69 O.R. (2d) 26 (H.C.) aff'd (1992), 11 O.R. (3d) 639 (C.A.) (memorized lists cannot be used).

<sup>42</sup> See the text accompanying note 114 below.

being in the public domain or becoming publicly available, an employee may continue to be restricted from using that information in competition with his or her employer, if it provides the employee with an advantage over other members of the public.<sup>43</sup> This principle, referred to as the “springboard” doctrine, is discussed in greater detail below,<sup>44</sup> under the heading “Injunctive Remedies”.

Given the potential for overlap of confidential information and trade secrets on the one hand and the employee’s personal skill and knowledge on the other, the employer has an interest in stressing the confidential nature of information provided to its employees in an attempt to broaden the class of information that may be protected. To this end, an employer should mark sensitive information as confidential and take other steps to reinforce the confidential status of particularly sensitive information, such as limiting access to this information by employees and outside parties.<sup>45</sup> These steps will not only help to prevent the unwitting disclosure of sensitive information, but will also assist in a lawsuit for breach of confidence. Markings and warnings will help the court in identifying which information should be the subject of injunctive relief. These steps may even assist, in very rare cases, in obtaining punitive damages for egregious breaches of the duty of fidelity by demonstrating that the employee was clearly aware that the information improperly used was confidential.<sup>46</sup>

### 3. *Duty of Disclosure*

In addition to the employee’s negative obligations to refrain from competing with the employer and disclosing the employer’s confidential information, the case law also imposes a positive obligation to disclose relevant information. Withholding information relevant to the employer may be inconsistent with the employee’s faithful discharge of his or her duties.<sup>47</sup> In *Smith v. Kamloops & District Elizabeth Fry Society*, the British Columbia Court of Appeal upheld the dismissal of a social worker who concealed a sexual relationship with a client despite an ethical code prohibiting sexual intimacy with clients and requiring the disclosure of conflicts.<sup>48</sup> The Court of Appeal held that the dismissal was justified since the employee’s conduct was sufficiently serious, and was incompatible with the faithful discharge of

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<sup>43</sup> *Schauenburg Industries Ltd. v. Borowski*, *supra* note 15.

<sup>44</sup> See “Injunctive Remedies” below.

<sup>45</sup> *Brait*, *supra* note 7 at 192-3.

<sup>46</sup> *Ibid.*

<sup>47</sup> *Smith v. Kamloops & District Elizabeth Fry Society* (1996), 20 C.C.E.L. (2d) 303 (B.C.C.A.).

<sup>48</sup> *Ibid.*

her duties to her employer.<sup>49</sup>

Similarly, in *Courtright v. Canadian Pacific Ltd.*, the employer was allowed to avoid a contract of employment on the ground that the prospective employee, a solicitor, was under criminal investigation.<sup>50</sup> The solicitor's non-disclosure constituted a failure to meet the standards of good faith required in negotiations for the contemplated professional relationship.<sup>51</sup>

### *B. Ownership of the Employee's Work Product*

In general, the courts have stated that an employer owns the intellectual property created by an employee during the course of employment, where that employee has been hired for the purpose of innovating.<sup>52</sup> This principle was stated in *Seanix Technology Inc. v. Ircha*:<sup>53</sup>

[W]here an employee is engaged to innovate, and creates something new or different in the course of those duties, the invention belongs to the employer. While the mere fact of employment does not obligate an employee to transfer an invention to the employer, where it is the product of the very work that the employee is paid to do, then the employer is the rightful owner of the invention.<sup>54</sup>

Outside of those instances of inventions made in the course of employment by employees who have been hired to innovate, the ownership of rights question becomes more complicated. The specific rights and obligations of the employee and employer with respect to the ownership of, and rights in, intellectual property differ depending on which intellectual property rights are being considered (copyrights, patents or trade secrets).

The ownership of copyrights created by an employee in the course of employment presumptively vests in the employer unless the parties agree otherwise.<sup>55</sup> This rule is set out in Section 13(3) of the federal *Copyright Act*, which provides:

<sup>49</sup> *Ibid.*

<sup>50</sup> (1983), 45 O.R. (2d) 52 (H.C.J.), appeal dismissed (1985), 50 O.R. (2d) 560 (C.A.).

<sup>51</sup> *Ibid.*

<sup>52</sup> *Comstock Canada v. Electec Ltd.* (1991), 38 C.P.R. (3d) 29 (F.C.T.D.). See also *Helbig v. Oxford Warehousing Ltd. et al.* (1985), 51 O.R. (2d) 421 (C.A.).

<sup>53</sup> (1998), 78 C.P.R. (3d) 443 (B.C.S.C.).

<sup>54</sup> *Ibid.* at 445.

<sup>55</sup> *BBM Bureau of Measurement v. Cybernauts Ltd.* (1992), 8 C.P.C. (3d) 293 (Ont. Gen. Div.).

Where the author of a work was in the employment of some other person under a contract of service or apprenticeship and the work was made in the course of his employment by that person, the person by whom the author was employed shall, in the absence of any agreement to the contrary, be the first owner of the copyright...<sup>56</sup>

In *Netupsky v. Dominion Bridge Co.*,<sup>57</sup> the Supreme Court of Canada held that an engineering firm owned a copyright in the structural plans of steelwork for a building. In this case, the court found that a professional engineer was the actual author of the plans, however, his work in producing the plans was undertaken for the engineering firm under an employment contract.

The situation is different with respect to patents. The federal *Patent Act*<sup>58</sup> provides that inventors are the first owners of their inventions, however, the *Act* fails to specify what happens when an inventor is an employee. Therefore, it is necessary to look to the common law. In Canada, the common law rule is that the existence of an employment relationship does not disqualify employees from patenting inventions made during the course of their employment.<sup>59</sup> This rule applies even where the invention relates to an aspect of the employer's business, the employee used the employer's time and materials to complete the invention, and the employee has allowed the employer to use the invention while he or she was employed.<sup>60</sup>

In *Comstock Canada v. Electec Ltd.*,<sup>61</sup> Muldoon J. of the Federal Court Trial Division held that the employee is impliedly entitled to the full benefit of an invention even though he or she may have used the employer's time and resources to produce it.<sup>62</sup> Muldoon J. further stated that there are two exceptions to the presumption that employees own their own inventions: (a) where there is an express contract to the contrary; or (b) where the person was expressly employed for the purpose of inventing or innovating.<sup>63</sup> The court stated that it would be

<sup>56</sup> R.S.C. 1985, c. C-42 s. 13 (3).

<sup>57</sup> [1972] S.C.R. 368.

<sup>58</sup> R.S.C. 1985, c. P-4. Under sections 27 and 49 of the *Patent Act*, a patent must be granted to the inventor or the inventor's legal representative unless the inventor has assigned or bequeathed the right to obtain the patent to someone else.

<sup>59</sup> *Piper v. Piper* (1904), 3 O.W.R. 451 (Ont. C.A.) at 455 and *Worthington Pumping Engine Co. v. Moore* (1902), 19 T.L.R. 84 (Eng. Ch. D.) at 87.

<sup>60</sup> *Ibid.*

<sup>61</sup> *Supra* notes 52 at 53 and *Re Equator Manufacturing Co.*, [1926] 1 D.L.R. 1101 (Ont. S.C.) at 1105.

<sup>62</sup> *Ibid.* at 52.

<sup>63</sup> *Ibid.* Muldoon J. gave the following, non-exhaustive, examples of what would constitute such evidence: (a) the employee was hired for the express purpose of inventing; (b) the employee at the time of hiring had previously made inventions; (c)

unusual for the presumption to shift in favour of the employer owning an invention unless the employee was engaged specifically because of his or her “inventive skills...[and] creates something in the ordinary course of his [or her] duties.”<sup>64</sup>

With respect to trade secrets, the principles for determining the respective ownership rights of employers and employees are set out in *Canadian Aero Service Ltd. v. O'Malley*,<sup>65</sup> and *The Lang Company v. Platt*.<sup>66</sup> Both of these cases cite the Quebec decision, *Positron Inc. v. Desroches*.<sup>67</sup> In *Positron*, the court acknowledged the rule that inventions made by the employee during the course of employment belong to the employer.<sup>68</sup> The court found that trade secrets cannot be disclosed or used other than for the benefit of the employer:

...there are...specific trade secrets so confidential that, even though they may necessarily have been learned by heart and even though the servant may have left the service, they cannot lawfully be used for anyone's benefit but the master's.<sup>69</sup>

To avoid the uncertain position with respect to the ownership of patents, and also to avoid arguments that an employee has developed something outside of the course of his or her employment, it is prudent for employers to put in place a written agreement covering the ownership of intellectual property. These types of agreements are typically called “Invention and Trade Secret Agreements.”<sup>70</sup>

### C. Fiduciary Employees

The fiduciary relationship between an employer and its high-level management employees imposes upon those employees a fiduciary obligation of loyalty, good faith and avoidance of conflicts of duty and self interest. This obligation is in addition to the duty of fidelity they

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the employer had incentive plans encouraging product development; (d) the conduct of the employee once the invention was created suggested ownership was held by the employer; (e) the invention was the product of the problem the employee was instructed to solve; (f) the employee's invention arose following his or her consultation through normal company channels; (g) the employee was dealing with highly confidential information or confidential work; and (h) it was a term of the employee's employment that he or she could not use the ideas that he or she developed to his or her own advantage.

<sup>64</sup> *Ibid.* at 54.

<sup>65</sup> [1974] S.C.R. 592.

<sup>66</sup> [1973] C.A. 1068 (Que.).

<sup>67</sup> *Supra* note 6.

<sup>68</sup> *Ibid.*

<sup>69</sup> *Ibid.* at p. 40, quoting *Faccenda Chicken*, *supra* note 30.

<sup>70</sup> See “Invention and Trade Secret Agreements” below.

owe as employees. This obligation places limitations on the employee's ability to compete with his or her employer.<sup>71</sup> These limitations last for a reasonable time after the employment relationship ends,<sup>72</sup> and, *inter alia*, prevent the fiduciary employee from intercepting the employer's corporate opportunities.<sup>73</sup> For instance, the employee cannot obtain contracts for his or her personal benefit that might have been available to the former employer, and cannot solicit the former employer's customers<sup>74</sup> or employees<sup>75</sup> in order to cause them to leave the former employer.

The prohibition against intercepting corporate opportunities is described by Laskin C.J.C. in *Canadian Aero Service Ltd. v. O'Malley*,<sup>76</sup> still the leading Canadian case on the issue, as follows:

An examination of the case law in this Court and in the Courts of other like jurisdictions on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping it for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.<sup>77</sup>

The employee is not precluded from competing with the former employer altogether. Rather, the employee is precluded from resigning so as to obtain for himself or herself "a fresh corporate opportunity which has developed to a point where it is about to ripen" and that was available to the employer and not readily so to its competitors.<sup>78</sup>

The prohibition against soliciting customers and employees is also not absolute. In limited cases a fiduciary employee may advertise his or her competing business, and in some cases may even notify customers of his or her former employer that he or she will be establishing a new

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<sup>71</sup> *Sure-Grip Fasteners Ltd. v. Allgrade Bolt & Chain Inc.* (1993), 45 C.C.E.L. 276 (Ont. Gen. Div.).

<sup>72</sup> *Ibid.*

<sup>73</sup> *Pizza Pizza Ltd. v. Gillespie* (1990), 75 O.R. (2d) 225 (Gen. Div.); *Berkey Photo (Canada) Ltd. v. Ohlig* (1983), 2 C.C.E.L. 113 (Ont. H.C.J.).

<sup>74</sup> *Canadian Industrial Distributors Inc. v. Dargue* (1994), 7 C.C.E.L. (2d.) 60 (Ont. Gen. Div.).

<sup>75</sup> *Berkey Photo (Canada) Ltd. v. Ohlig* (1983), *supra* note 73.

<sup>76</sup> *Supra* note 65.

<sup>77</sup> *Ibid.* at 607.

<sup>78</sup> *Berkey Photo (Canada) Ltd. v. Ohlig*, *supra* note 73 at p. 129.

business.<sup>79</sup> But actively soliciting the former employer's customers is prohibited.<sup>80</sup>

As noted above, the constraints on post-employment competition by fiduciaries endure for a "reasonable" time after the employment relationship ends. The courts have determined the period of time for which the employee owes a fiduciary duty by referring to various features of the employment relationship. Some cases have considered appropriate the period of time required for the employer to replace the former employee and to adequately train the replacement employee.<sup>81</sup> Other cases have looked to the period of time required for the employer to re-establish the departing fiduciary's relationship of trust with clients or customers; this depends on the degree of trust placed in the employee and the corresponding vulnerability of the employer.<sup>82</sup> The result has been a range of reasonable periods. For example, in *Canadian Industrial Distributors Inc. v. Dargue*,<sup>83</sup> 6 months was deemed an adequate period, and in *Alberts v. Mountjoy*,<sup>84</sup> 2 years was considered reasonable.

Determining who is an employee impressed with fiduciary obligations can be difficult. Employees in certain positions are clearly fiduciaries; this class includes a company's president, its general managers, and others in similar positions of effective control.<sup>85</sup> But the boundaries of this class are not clear. For example, departmental and regional managers, less senior employees that certainly do not have control over the business as a whole, have been found to owe their employers a fiduciary duty where they occupy a key role in the department's or the business's regional operations and have long and close associations with customers.<sup>86</sup>

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<sup>79</sup>*Layne v. Michaels* (1990), 32 C.C.E.L. 144 (B.C.S.C.). This decision would appear to be limited to professionals with particular relationships with and duties to their clients including the duty to inform clients of their departure in order that clients can choose to continue to use the departing professional's services. See, e.g., *Clarke v. Rossburger* (1999), 50 B.L.R. (2d) 73 (Alta. Q.B.).

<sup>80</sup> Brait, *supra* note 7 citing *W.J. Christie & Co. v. Greer*, [1981] 4 W.W.R. 34; *White Oaks Welding Supplies v. Tapp* (1983), 42 O.R. (2d) 445 at 449 (H.C.) (breach is in soliciting other than as a member of the public).

<sup>81</sup> *Canadian Industrial Distributors Inc. v. Dargue*, *supra* note 74.

<sup>82</sup> *Anderson, Smyth, & Kelly Customs Brokers Ltd. v. World Wide Customs Brokers* (1996), 20 C.C.E.L. (2d) 1 at para. 32 (Alta. C.A.).

<sup>83</sup> *Supra* note 74.

<sup>84</sup> (1977), 16 O.R. (2d) 682 (H.C.).

<sup>85</sup> Brait, *supra* note 7 at 191.

<sup>86</sup> E.g., *Hudson's Bay Company v. McClocklin*, (1986), 42 Man. R. (2d) 283 (Q.B.), and *Smith v. UndercoverWear Ltd.* (1993), 51 C.P.R. (3d) 409 (Ont. Gen. Div.) and *EII Ltd. v. Dutko* (1997), 119 Man. R. (2d) 178 at para 5 (Man. Q.B.).

### *III. Establishing the Employment Relationship*

As has been noted in section II, there are a number of gaps in the rights provided to employers under the general law.

To address these issues, employers in the technology field will typically employ several written agreements or policies. In order to more thoroughly protect sensitive information and intellectual property, the employer will almost always require incoming employees to sign an agreement dealing with inventions and trade secrets. To address the issue of competition during employment, employers will often use an agreement or policy about conflicts of interest. Finally, to address both these concerns in the context of the digital office environment, companies will establish policies about e-mail and Internet use, and may require explicit agreements or consents from employees. The utility of these agreements and some issues surrounding them are discussed below.

#### *A. Intellectual Property and Confidentiality*

Most employers will have all employees sign a distinct agreement which is often referred to as an “invention and trade secret” agreement. It will address both the employee’s obligation not to disclose confidential information and the employer’s ownership of intellectual property developed during the employment relationship. These agreements typically require that the employee keep the employer’s information confidential and not use it otherwise than for the employer’s benefit. They specify that this obligation continues after employment has terminated, and carefully set out the types of information covered by the obligation. In this latter respect they may assist in having information held to be confidential to which the courts would otherwise deny protection.<sup>87</sup> These agreements also have an assignment provision: inventions and other developments related to the employer’s business (or potential future business) made by the employee during the currency of employment are assigned to the employer.<sup>88</sup>

In general, in the absence of a written assignment, the employer will have rights to various forms of intellectual property developed by the employee during the course of employment. The advantage of a written agreement is that an employer can expand these rights to include inventions and other developments created outside of the regular course of employment. A typical provision claiming such

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<sup>87</sup> Such as “know how”, or the type of confidential information referred to in *Faccenda Chicken*, *supra* note 30.

<sup>88</sup> Brait, *supra* note 7.

additional rights might read as follows:

I hereby assign to and waive in favor of the Company all my right, title and interest, in, to and under all Intellectual Property (including moral rights), which I may create, conceive, develop or reduce to practice during my employment with the Company and which:

(i) relates directly or indirectly, to the Company's present or reasonably foreseeable business, research or development; or,

(ii) results from any work performed by me for the Company; or,

(iii) is created, conceived, developed or reduced to practice using any equipment, supplies, resources, Intellectual Property or Confidential Information of the Company;

whether or not done during or after working hours, on or off the Company's premises, or alone or with others.<sup>89</sup>

Having an employee sign such an agreement at the start of employment presents no difficulties vis-à-vis consideration. However, if an employee is requested to sign such an agreement during employment the employer should carefully structure the transaction to ensure there is consideration. In the case of *Techform Products Ltd. v. Wolda*,<sup>90</sup> a retired engineer signed a contract with Techform to work on special projects as a consultant. Later, Techform required the engineer to sign an Employee Technology Agreement (ETA), which stated that the Company would own all of the rights to anything invented while he was consulting for it. The consideration for the ETA was "continuing employment" with Techform. In 1996 the engineer designed a tailgate hinge at the request of the company and a "3D" hinge on his own initiative. The Court of Appeal held that the trial judge erred in finding that there was no consideration for the agreement and that continued employment and Techform's implied forbearance from exercising its contractual right to dismiss on reasonable notice constituted adequate consideration in the circumstances of this case. In part, this was due to the finding that Techform did intend to terminate those who decided not to sign the ETA. However, in many cases mere continued employment may not suffice as consideration.

The following additional provisions might also be included in an invention and trade secret agreement:

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<sup>89</sup> A provision found in a typical standard form agreement.

<sup>90</sup> (2001), 56 O.R. (3d) 1 (Ont. C.A.).

1. the employee represents that he or she has no obligations that are inconsistent with those he or she is assuming in respect of the new employer;
2. the employee will transfer to the employer the physical property in any items developed while employed;
3. the incoming employee lists any inventions or ideas that he or she has conceived or developed before starting employment, and states that these are the only such inventions and ideas;
4. the employee has a duty to disclose to the employer all inventions or developments he or she makes while employed, and to execute any assignments or other assurances that may be required to perfect the employer's interest in them; and
5. the employee's use of his or her own skill and knowledge will not be restrained when he or she leaves employment, and no claim is made against items in the public domain.<sup>91</sup>

The first four terms above clarify each party's rights and obligations respecting inventions and trade secrets. The last term can help in demonstrating to a court that the employer is not trying to overreach in establishing its rights as against the employee. Such a term may be useful as evidence should the need arise to assert the enforceability of restrictive covenants governing the employee's activities post-employment, an issue addressed below under the heading "Restrictive Covenants".

### *B. Conflicts of Interest*

Conflict of interest policies or agreements typically forbid the interception of corporate opportunities, and the acceptance of gifts from suppliers. They also require the disclosure of interests in competing companies.<sup>92</sup> These policies or agreements address only the period of employment. High-level employees whose conflicts are more likely to harm the company are often required to sign separate agreements restricting their post-employment activities. The nature and scope of these agreements are discussed below under the heading "Restrictive Covenants".

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<sup>91</sup> Brait, *supra* note 7 at 195.

<sup>92</sup> *Ibid.*

### C. E-mail and Internet Policies

The ease of information transfer by e-mail and the Internet presents a significant threat to an employer's confidential information through potentially improper activities by employees. Consequently, many employers monitor their employees' use of these electronic tools. Although Canadian courts have not specifically addressed the legality of employer monitoring, it appears that employers may monitor e-mail, though it should be done in accordance with a stated policy to which the employee has consented.

The first source of protection is the *Criminal Code of Canada*.<sup>93</sup> It prohibits the wilful interception of private communications, and imposes a term of up to five years imprisonment for violations.<sup>94</sup>

Whether the *Criminal Code* provision applies to a communication depends on whether the communication carries a reasonable expectation of privacy. Whether this expectation exists in the workplace is unclear. Although a reasonable expectation of privacy in personal e-mail stored with an Internet service provider has been judicially recognised,<sup>95</sup> no Canadian court has yet pronounced on monitoring by an employer. The latter situation differs significantly from the former; the employer provides access and infrastructure to its employee primarily for use in the course of employment, and not, as is the case for an Internet service provider, for private use. Further, monitoring by the employer can be justified by the employer's proprietary interest in the system and its contents. Monitoring may be necessary, for example, to maintain the system and the confidentiality of the information on it, and to avoid liability for its improper use by employees to the harm of third parties. These arguments are supported by American jurisprudence,<sup>96</sup> and by the recent decision of a British Columbia arbitrator.<sup>97</sup> In the latter case the employee sent his e-mail to a distribution list on the employer's system, and this was regarded by the arbitrator as putting the employee on notice that his e-mail might be monitored.

Recently, the House of Commons passed Bill C-14<sup>98</sup> amending the

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<sup>93</sup> R.S.C. 1985, c. C-46 [*Criminal Code*].

<sup>94</sup> *Ibid.*, s. 184(1).

<sup>95</sup> *R. v. Weir* (1998), 213 A.R. 285 (Q.B.).

<sup>96</sup> C. Morgan, "Employer Monitoring of Employee Electronic Mail and Internet Use" (1999) 44 McGill L.J. 849.

<sup>97</sup> *Camosun College v. Canadian Union of Public Employees, Local 2081 (Metcalfe Grievance)*, [1999] B.C.C.A.A.A. No. 490.

<sup>98</sup> Bill C-14. *An Act to Amend the Criminal Code and Other Acts*, S.C. 2004, c. C-46.

interception of communication provisions in the *Criminal Code*. As a result of these changes, the general prohibition on the willful interception of private communications does not apply to persons who intercept private communications originating from, directed to, or transmitting through a computer system in their possession or control, if the interception is reasonably necessary to either manage the quality of service, integrity and availability of the system or protect the computer system against any act that would otherwise be an offence under the *Criminal Code* (specifically, mischief or the unauthorized use of computer systems). These recent amendments are designed to address technologies that collect private data and which would have otherwise been subject to the prohibition on interception of communications.

Additionally, the *Criminal Code* prohibition against the interception of private communications does not apply where the person intercepting the communication has consent to do so from the person sending or receiving the communication. This provides the employer the option of obtaining a blanket consent from its employees to monitor them.

Current federal and provincial privacy legislation may also place some limits on the monitoring of e-mail and Internet use, or at least provide further reason to obtain employees' consent to monitoring. Newfoundland,<sup>99</sup> Saskatchewan,<sup>100</sup> British Columbia<sup>101</sup> and Manitoba<sup>102</sup> all have provincial privacy statutes that create tort liability for actions that violate an individual's privacy. In Québec, privacy is protected by the *Québec Charter of Human Rights and Freedoms*<sup>103</sup> and the *Civil Code of Québec*.<sup>104</sup> The former includes an individual right to have one's privacy respected; the latter prohibits the invasion of privacy, including by intercepting private communications. However, like the *Criminal Code*, the provincial legislation (other than the *Québec Charter*, whose protection is of a more general nature) excludes activities for which consent has been obtained.

Similarly, subsection 5(3) of the federal *Personal Information Protection and Electronic Documents Act* (PIPEDA)<sup>105</sup> provides that "an organization may collect, use or disclose personal information only for purposes that a reasonable person would consider are appropriate in

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<sup>99</sup> *An Act Respecting the Protection of Personal Privacy*, S.N. 1981, c. 6.

<sup>100</sup> *Privacy Act*, R.S.S. 1978, c. P-24.

<sup>101</sup> *Privacy Act*, R.S.B.C. 1996, c. 373.

<sup>102</sup> *Manitoba Privacy Act*, R.S.M. 1987, c. P-125.

<sup>103</sup> R.S.Q. 1977 c. C-12 [*Québec Charter*].

<sup>104</sup> 1 S.Q. 1980, c. 39 [C.C.Q.].

<sup>105</sup> A copy of the federal legislation can be found online: Officer of the Privacy Commissioner of Canada <[http://www.privcom.gc.ca/legislation/index\\_e.asp](http://www.privcom.gc.ca/legislation/index_e.asp)>.

the circumstances.” PIPEDA applies to personal information of employees of federally-regulated enterprises. It also applies to personal information of customers, and others dealt with by all enterprises in Canada, except in those provinces which have enacted substantially similar legislation (so far, formally only Québec although it is expected to also be the case for British Columbia and Alberta).

On 1 January 2004, private-sector privacy legislation enacted by both Alberta and British Columbia came into force. The legislation in both provinces applies to the collection, use or disclosure of personal information.<sup>106</sup> The Federal government has not yet declared those two statutes to be substantially similar to PIPEDA and therefore, both PIPEDA and the provincial legislation are applicable in Alberta and British Columbia.

To avoid a judicial finding that an employer’s monitoring of e-mail or Internet use infringes privacy in violation of the *Criminal Code* or applicable privacy legislation, employers ought to obtain their employees’ consent. The consent document should refer to a policy on monitoring that sets out the scope of monitoring that the employer will conduct. This policy should not be overstepped in practice. Further, to avoid problems with the enforceability of agreements in the absence of consideration, the employer should obtain such consent at the time the employment agreement is entered into. This is a preferable route to including the documents as an afterthought among the materials given to the employee at the beginning of employment.<sup>107</sup> Finally, as an ongoing measure, a company’s intranet may also refer to the policy so that each time an employee logs onto the system, he or she is notified that using the system is subject to the employer’s e-mail and Internet policy.<sup>108</sup> Whether this sort of reminder should be used depends on balancing the importance of reinforcing the employee’s awareness of his or her rights and obligations on the one hand and maintaining employee morale on the other.

#### *D. Restricting Post-Employment Activities*

In addition to the types of agreements discussed above, written employment agreements often contain covenants prohibiting an employee from establishing or obtaining employment with a competitor, or from soliciting the former employer’s customers or

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<sup>106</sup> *Personal Information Protection Act* (British Columbia), S.B.C. 2003, c. 63 and the *Personal Information Protection Act* (Alberta), S.A. 2003, c. P-6.5.

<sup>107</sup> Alan M. Gahtan, Martin P.J. Kratz, and J. Fraser Mann, *Internet Law: A Practical Guide for Legal and Business Professionals* (Toronto: Carswell, 1998) at 359.

<sup>108</sup> Morgan, *supra* note 96 at para. 161.

employees. The general rule is that these provisions are void for being in restraint of trade.<sup>109</sup> But there are exceptions. The enforceability of restrictive covenants is governed by the restraint of trade doctrine. Below is a discussion of the scope of this doctrine as it relates to: (i) post-employment restraints on the employee's use of confidential information, solicitation of the employer's customers and employees, and competition generally; and (ii) contractual terms tying non-competition obligations to some aspects of compensation. The latter have, to date, avoided censure by the courts, and offer an alternative means for employers to protect their interests.

### *1. The Restraint of Trade Doctrine*

A contractual term will be in restraint of trade and unenforceable where "a restraint is imposed upon the liberty of an individual to earn his living or exercise his calling, or in other words a contract whereby the individual liberty of action is interfered with and controlled ...".<sup>110</sup> In the leading case of *J.G. Collins Insurance Agencies Ltd v. Elsley Estate*,<sup>111</sup> the Supreme Court of Canada summarized the law as follows:

The principles to be applied in considering restrictive covenants of employment are well-established. ... A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest. As in 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.<sup>112</sup>

The effect of the doctrine is that covenants restraining the use of confidential information, the solicitation of former colleagues and customers of the former employer, and other competitive activities, must be reasonable in terms of the activities they restrain, their duration, and the geographical area over which they apply. The nature of what is being restrained is also an important factor. Thus a covenant may be much more difficult to defend if it is directed against competition generally and not limited to proscribing solicitation of

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<sup>109</sup> *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co. Ltd.*, [1894] A.C. 535 (H.L.).

<sup>110</sup> *Hepworth Manufacturing Co. v. Ryott* (1919), [1920] 1 Ch. 1 at 33 (C.A.).

<sup>111</sup> [1978] 2 S.C.R. 916.

<sup>112</sup> *Ibid.* at 923.

clients or some other more limited activity.<sup>113</sup>

## 2. Confidentiality, Non-Solicitation and Non-Competition Clauses

The least problematic covenant will be one aimed at restraining an ex-employee's use of the former employer's confidential information. These covenants are often very broadly framed, prohibiting the use of "confidential information" generally.<sup>114</sup> They are broad simply because the alternative (that is, an exhaustive list of the specific information of the employer that the covenant should cover) would be impractical and costly to define and keep current. A provision forbidding the use of "confidential information" generally, without further definition, however, risks being held to be overly broad. The potential offensiveness of such a term is that it may appear to a court to be an attempt to control the use of information in which the employer has no proprietary interest, that is the employee's own knowledge and skill. In the situation where there is no written agreement, a court will not imply a term preventing an employee from using his or her own knowledge and skill obtained through employment; nor will the courts enforce a covenant in a written agreement that seeks to do the same.<sup>115</sup> It is

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<sup>113</sup> *Lyons v. Multari* (2000), 50 O.R. (3d) 526 (C.A.), application for leave to appeal to the S.C.C. dismissed, [2000] S.C.C.A. no. 567. This case has been followed in *Orlan Karigan & Associates Ltd. v. Hoffman* (2001) 5 C.C.E.L. (3d) 311 (Ont. S.C.J.), considered in *Kohler Canada Co. v. Porter* (2002), 17 C.C.E.L. (3d) 274 (Ont. S.C.J.) and referred to in *Infinite Maintenance Systems Ltd. v. ORC Management Ltd.* (2001), 139 O.A.C. 331 (C.A.), *Button v. Jones* (2001), 11 C.C.E.L. (3d) 312 (Ont. S.C.J.) and *Valley First Financial Services Ltd. v. Trach* (2003) B.C.S.C. 223.

<sup>114</sup> Brait, *supra* note 7 at 200.

<sup>115</sup> In the English Court of Appeal decision in *Faccenda Chicken*, *supra* note 30, Neill L.J. suggests in *obiter dictum* that there are different levels of confidential information and that the least confidential forms may not constitute a legitimate proprietary interest, and thus may not be validly included in a restrictive covenant. England, Christie and Wood suggest, however, that since this aspect of the judgment has not been approved in Canada, "all information that passes the threshold of "confidentiality" is capable of constituting a "legitimate" interest of the purpose of a post-employment restrictive covenant...": England, Christie and Wood, *supra* note 8 at para. 11.36.1. In *Maguire v. Northland Drug Co.*, [1935] S.C.R. 412, the Supreme Court of Canada found that: "[t]he information and training which an employer imparts to his employee become part of the equipment in skill and knowledge of the employee, and so are beyond the reach of such a covenant..." As a general rule, an employee may leave his or her employment and use the skills and knowledge acquired during the course of employment to compete with his or her former employer, however, he or she may not take or use against his or her employer any of the employer's trade secrets, confidential information or customer lists. See *Tree Savers International Ltd. v. Savoy*, [1991] 6 W.W.R. 84 at 87 (Alta. Q.B.), *var'd* (1992), 39 C.C.E.L. 253 (Alta. C.A.) and *Barton Insurance Brokers Ltd. v. Irwin* (1999), 170 D.L.R. (4<sup>th</sup>) 69 at 76-77 (B.C.C.A.).

therefore wise to provide in a covenant restricting the use of confidential information a proviso to the effect that no attempt is being made to restrain the use of the employee's personal knowledge and skill.

However, some courts have distinguished between purely personal knowledge and skill, whose use cannot be restrained, and "know-how", whose use can be restrained by an appropriately crafted covenant.<sup>116</sup> When distinguishing between personal skill and knowledge and know-how, the court will consider whether the employee's function was to innovate, rather than to execute a standard production function. If the knowledge arose in the former context, the court is more likely to find that the information is know-how, and thus the proper subject of a restraint.<sup>117</sup> The distinction between personal information and know-how was made in *Commercial Plastics v. Vincent*.<sup>118</sup> In that case, the employee was a plastics technologist who conducted research to develop adhesive tape sheeting. The court held that the employee's knowledge could be protected by covenant since he was likely to remember "in general terms what was the problem and what was the solution, what experiments were made and whether the results were positive or negative and so on."<sup>119</sup> The court found that the former

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In *Consolidated Textiles Ltd. v. Central Dynamics Ltd.* (1974), 18 C.P.R. (2d) 1 at 9-10, Addy J. made the following point:

A duty to refrain from using or divulging trade secrets does not prevent a person from using general skill and knowledge acquired whilst in the employ of another. Both he and the general public are entitled to the benefit of this acquired general skill and knowledge. Objective knowledge such as trade secrets and the names of customers are to be distinguished from subjective or general knowledge, such as the method of carrying out a process or procedure generally known to persons in the trade or occupation or readily ascertainable by them.

<sup>116</sup> Brait, *supra* note 7, citing *Printers & Finishers Ltd. v. Holloway*, *supra* note 32 and *Commercial Plastics Ltd. v. Vincent*, [1965] 1 Q.B. 623 (C.A.) (C.A.).

<sup>117</sup> Protection has been granted when the business process involved is unique and very specific (*Cooks Australian Directories Pty., Ltd. v. Stratton* (1946), 47 S.R.N.S.W. 189 (N.S.W.S.C.)) Fairly routine knowledge such as an employee's knowledge of his employer's business organization, such as internal organization and sales techniques, is seldom subject to protection. As to the skills taken with a departing employee, Lord Atkinson said in *Herbert Morris Limited v. Sazelby*, *supra* note 39 at 704-705:

[A] man who goes into an other office is entitled to make use in any office, whether his own or that of another employer, of the knowledge which he has acquired in the former of details of office organization...the knowledge of the reasonable mode of general organization and management of the business of this kind, and to make use of such knowledge, cannot be regarded as a breach of confidence...although the person may have learnt it in the course of being taught his trade...

<sup>118</sup> *Supra* note 116.

<sup>119</sup> *Ibid.* at p. 642.

employee's knowledge was not disqualified from protection as being part of his personal skill since:

In this case the distinctive feature distinguishing it from *Herbert Morris Ltd. v. Saxelby* is the element of continuing new discovery of further advantageous methods or devices for producing sheeting for adhesive tape.<sup>120</sup>

If an employee is involved in developing new procedures or methods, then the knowledge acquired from such activity may be subject to restraint even without a covenant, whereas knowledge acquired in the context of a continuing and standard production activity will most likely not merit protection unless it is dealt with by covenant.

In addition to extending the protection available for an employer's proprietary interest in trade secrets and other confidential information, courts have recognized that restrictive covenants may be used to protect the employer's proprietary interest in customers and other trade contacts. Thus courts have enforced non-solicitation covenants aimed at restricting employees from enticing former colleagues<sup>121</sup> and customers<sup>122</sup> of their former employers to leave the former employer and join a competitive business. In particular, a court will recognize a proprietary interest in specific customers where the employee has acquired "a special and intimate knowledge of the customers of his employer and the means of influence over them".<sup>123</sup>

Pure non-competition covenants, that is, covenants that restrain an employee from starting or joining a competing business, have also been held to be enforceable by the courts, though only in exceptional cases. In *Elsley Estate v. J.G. Collins Insurance Agencies Ltd.*,<sup>124</sup> the respondent insurance company (*Collins*) purchased from the appellant (*Elsley*) a general insurance business. By a second employment agreement between the parties, *Elsley* was employed as manager of *Collins'* operations, subject to the restrictive covenant that *Elsley* not become engaged in the business of a general insurance agent while employed by *Collins* or for a 5-year period after the termination of such employment. In comparing such restrictive covenants in agreements of purchase and sale with similar covenants in employment agreements, Dickson J., on behalf of the Supreme Court of Canada, observed that

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<sup>120</sup> *Ibid.* at p. 642-43.

<sup>121</sup> R. Sider and M. Dhaliwal, "Issues of Confidentiality and Competition in the IT Sector" (paper presented to the Canadian IT Law Association, Vancouver Conference, 26 October 2001) [unpublished], and England, Christie and Wood, *supra* note 4 at para. 11.36.

<sup>122</sup> *J.G. Collins Insurance Agencies Ltd. v. Elsley Estate*, *supra* note 111.

<sup>123</sup> *Ibid.* at p. 926.

<sup>124</sup> *Ibid.* at p. 923-24.

restrictive covenants in employment contracts stand on a separate footing from similar covenants in other commercial contexts:

It is important, I think, to resist the inclination to lift a restrictive covenant out of an employment agreement and examine it in a disembodied manner...The distinction made in the cases between a restrictive covenant contained in an agreement for the sale of a business and one contained in a contract of employment is well conceived and responsive to practical considerations...in the negotiation of a contract of employment [there is] an imbalance of bargaining power [that] 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, skills obtained during employment...Although blanket restraints on freedom to compete are generally held unenforceable, the courts have recognized and afforded reasonable protection to trade secrets, confidential information, and trade connections of the employer.<sup>125</sup>

Notwithstanding the presumption of invalidity of restrictive covenants, a covenant may be upheld if the party seeking to enforce it can meet the elements of the test described in *Elsley*. First, the employer must show a legitimate business interest for seeking the covenant. Second, there must be a nexus between the covenant and the business interest sought to be protected. Third, the covenant must not overly impair the employee's post employment activities (taking into account the duration and geographic scope of the covenant). Finally, the covenant must not otherwise be contrary to the public interest.<sup>126</sup> In *Elsley*, the Supreme Court held that the non-competition covenant was valid on the basis that the clause was reasonable between the parties, the clause was not unenforceable as being against competition generally and the covenant was not contrary to the public interest.

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<sup>125</sup> *Ibid.* at p. 923-24. Under common law, restrictive covenants have been treated as presumptively invalid restraints on trade. This principle has been stated by Lord Macnaghten in *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co.*, *supra* note 109.

The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.

<sup>126</sup> *Ibid.* at p. 923.

Ontario courts will generally not enforce a non-competition clause if a non-solicitation clause would adequately protect the employer's interests. In the Ontario Court of Appeal decision in *Lyons v. Multari*,<sup>127</sup> the court held that a non-competition clause prohibiting a dental surgeon (who worked as an associate in a dental practice for 17 months) from working in a competing dental practice within five miles of the employer's practice for three years, was not enforceable and that the plaintiff's interests could have been protected by a non-solicitation clause. The court stated that "as a general rule, non-solicitation clauses are permissible; in 'exceptional cases' only, non-competition clauses will be upheld."<sup>128</sup>

Once the legitimacy of the proprietary interest to be protected is established, a court will consider the reasonableness of a covenant's spatial and temporal scope. In both respects, the restraint must not exceed what is reasonably required to protect the employer's proprietary interest.

The extent of the geographical area required to protect the proprietary interest in question will be determined by referring to the nature of that interest, and, if applicable, the boundaries of the market for that interest.<sup>129</sup> For example, where the former employer's clientele is restricted to an area smaller than the area specified in the restrictive covenant, the restraint on the employee will not be enforced.<sup>130</sup> In the case of covenants about the use of customer information, the restraint can extend no farther than the employee's special influence over these customers.<sup>131</sup>

The reasonableness of a restrictive covenant's duration will be assessed by starting with the same consideration as that of its geographical scope: what provision is reasonably required to protect the employer's proprietary interest? A permanent restraint will not be enforced other than in very rare cases.<sup>132</sup> The appropriate duration of a restraint on the disclosure of confidential information depends on the

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<sup>127</sup> *Supra* note 113.

<sup>128</sup> *Ibid.* at para. 49. The Court of Appeal found that in exceptional cases, the nature of the employment may justify a covenant prohibiting an employee not only from soliciting customers, but also from establishing his own business or working for others so as to be likely to appropriate the employer's trade connection through his acquaintance with the employer's customers or clients.

<sup>129</sup> England, Christie, and Wood, *supra* note 8 at para. 11.38.

<sup>130</sup> *Ernst & Young v. Stuart* (1993), 46 C.C.E.L. 161 (B.C.S.C.).

<sup>131</sup> *Stenhouse Australia Ltd. v. Phillips*, [1974] 1 All E.R. 117 (P.C.(Aus.)) at 123.

<sup>132</sup> *Nelson Burns & Co. v. Gratham Industries Ltd.* (1983), 42 O.R. (2d) 705 (H.C.); *aff'd* (1986), 55 O.R. (2d) 426 (C.A.). Leave to appeal to S.C.C. refused (1986), 56 O.R. (2d) 604.

useful life of the information. For example, the pace of technological advances in some fields makes trade secrets about production processes relatively valueless in a short period of time.<sup>133</sup> On the other hand, certain trade secrets that do not lose their value over time might warrant a long period of restraint.<sup>134</sup>

In the case of non-competition and non-solicitation clauses, the reasonable duration of a restraint has been equated to the length of time during which the employee has an advantage over the former employer because of his or her knowledge of and influence over customers.<sup>135</sup> In this context, courts are not likely to uphold a restrictive covenant that lasts longer than 18 months,<sup>136</sup> although longer periods have been upheld in cases dealing with professionals, particularly where they have sold their businesses.<sup>137</sup>

Having examined the proprietary interest involved, the type of activity sought to be restrained, and the scope of the restraint, a court will consider a final element; that is, whether it is against competition generally, in other words, against the public interest.<sup>138</sup> Under this heading, the courts will examine whether the restraint will deprive the market or the relevant community of service or of sufficient competition in the affected field of business. For example, where a community will not suffer for the loss of a single general insurance agent because twenty-two others remain in business, as was the case in *Elsley*, the restraint may be upheld. Conversely, where a restraint would prevent an obstetrician from practicing in a community short of such specialists, it will be held void as contrary to the public interest.<sup>139</sup>

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<sup>133</sup> England, Christie, and Wood, *supra* note 8 at para. 11.39.

<sup>134</sup> *Ibid.* See also *International Tools v. Kollar*, *supra* note 14 and *Schauenburg Industries Ltd. v. Borowski*, *supra* note 15.

<sup>135</sup> England, Christie, and Wood *supra* note 8 at para. 11.39; *Jostens Canada Inc. v. Gendron* (1994) 1 C.C.E.L. (2d) 275 (Ont. Gen. Div.).

<sup>136</sup> Howard A. Levitt, *Law of Dismissal in Canada*, 2<sup>nd</sup> ed. (Toronto : Canada Law Book, 1992) at 444, cited in D.Murray Tevlin and Shafik K. Bhalloo, "Employment Contracts: Enforcing Non-Competition" (1995) 53(6) *The Advocate* 879 at 884.

<sup>137</sup> See, e.g., *Elsley v. J.G. Collins Insurance Agencies Ltd.*, *supra* note 11 (5 years); *Lyons v. Multari*, *supra* note 113 (3 years).

<sup>138</sup> See, e.g., *Elsley v. J.G. Collins Insurance Agencies Ltd.*, *ibid.*, above note 111, *Canadian Factors Corp. v. Cameron*, [1971] S.C.R. 148; *Tank Lining Corp. v. Dunlop Industrial Ltd.* (1982), 40 O.R. (2d) 219 (Ont. C.A.); *Wooward v. Stelco Ltd.* (1986), 20 C.C.E.L. (2d) 70 (Ont. Gen. Div.), *aff'd* (1998), 80 C.P.R. (3d) 319 (Ont. C.A.), leave to appeal refused [1998] S.C.C.A. no. 455.

<sup>139</sup> *Sherk v. Horwitz*, [1972] 2 O.R. 451 (H.C.).

### 3. Judicial Interpretations of Restrictive Provisions

On occasion the courts will invalidate an overly broad restraint, but allow the employer to enforce a lesser one. The courts have achieved this in two main ways: (a) by “reading down” or severing an overly-broad restraint; or (b) by finding implied contractual or equitable duties.

#### (a) Reading Down and Severance

“Reading down” is a principle of contractual interpretation whereby a court effectively permits a restraint that is overly broad by restrictively interpreting its terms. This approach has allowed courts to restrict the scope of the industry and territory to which restraints have applied in order to eliminate their offensive breadth.<sup>140</sup> However, while some courts will read down from time to time, generally, they are very reluctant to do so.

Courts are more likely to be willing to sever offensive portions of a restrictive covenant, allowing the rest to continue in effect. This approach is called the “blue pencil” test, and will only be done where the covenant consists of separate and distinct parts, and where the offensive portions of the covenant can be removed without altering the meaning or intention of the agreement.<sup>141</sup> A discussion of the principles of severance and the “blue pencil” test is found in *Canadian American Financial Corp. (Canada) v. King*,<sup>142</sup> where Lambert J.A. stated:

It is only if the covenant is not valid as it stands that a question of severance arises. The courts have always resisted rewriting a contract that the parties have made. No doubt they will continue to do so. So whether the reason for the invalidity is because the covenant as it stands is void for uncertainty or because it is unreasonable either in reference to the interests of the parties or the interests of the public, the courts will only sever the covenant or expunge a part of it if the obligation that remains can fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agreed to it without varying any other terms of the contract or otherwise changing the bargain.<sup>143</sup>

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<sup>140</sup> See, e.g., *Home Counties Dairies Ltd. v. Skilton*, [1970] 1 All E.R. 1227 (C.A.); *Littlewood Organisation Ltd. v. Harris*, [1978] 1 All E.R. 1026, *H.F. Clarke Ltd. v. Thermidaire Corp.* (1974), [1976] 1 S.C.R. 319.

<sup>141</sup> S.M. Waddams, *The Law of Contracts*, 4<sup>th</sup> ed. (Toronto: Canada Law Book Inc., 1999); Fridman, below, note 158 at 443. The “blue pencil” test was first referred in a decision of the English Court of Appeal, *Attwood v. Lamont*, [1920] 3 K.B. 571 at 577-78 (C.A.), in which Lord Sterndale stated “ I think, therefore, that it is still the law that a contract can be severed if the severed parts are independent of one another and can be severed without the severance affecting the meaning of the part remaining.”

<sup>142</sup> (1989), 36 B.C.L.R. (2d) 257 (C.A.).

<sup>143</sup> *Ibid.* at p. 270.

The purpose of the severance is to retain the bargain between the parties and not impose a new bargain. Lambert J.A. stated that “courts ought not to use the “blue pencil” rule to make an agreement for the parties that they have been unable to make for themselves.”<sup>144</sup> This view was also espoused in *Maguire v. Northland Drug Co.*,<sup>145</sup> where the Supreme Court of Canada found that the “blue pencil” test should not be used to edit defective clauses.

The use of the “blue pencil” test is not predictable. Sometimes courts are willing to sever restrictive covenants and sometimes courts are not. There are several cases where a “blue pencil” approach was available but the courts refused to apply it. The courts will not use the doctrine of severance as an excuse to re-write the parties’ bargain. In *Canadian American*, the British Columbia Court of Appeal considered a contract for service that restricted the defendant from engaging in business “within Canada or Bermuda”. The Court of Appeal held that the geographical scope of the non-competition covenant was excessive and unreasonable.<sup>146</sup> Lambert J.A. stated that part of the covenant could be expunged only where the part that remains “can fairly be said to be a sensible and reasonable obligation in itself and such that the parties would unquestionably have agreed to it without varying any other terms of the contract or otherwise changing the bargain.”<sup>147</sup> The Court of Appeal held that the restrictive covenant was not severable. In the recent Ontario decision in *Orlan Karigan & Associates Ltd. v. Hoffman*,<sup>148</sup> Juriansz J. refused to sever the non-competition from the non-solicitation provisions of a restrictive covenant, and held that the covenant as a whole was void as being in restraint of trade.

Some Canadian courts have applied the “blue pencil” test and have been willing to sever portions of offending covenants. The courts have applied the test where the obligation to be severed is a separate and distinct covenant, the severance of the offending portion does not effect the meaning of the remaining contractual promise, and the severed obligation represents a reasonable arrangement between the parties.<sup>149</sup> In *Restauronics Services Ltd. v. Forster*,<sup>150</sup> the court concluded that the words “within British Columbia, Alberta and within a 100 mile radius

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<sup>144</sup> *Ibid.* at 271.

<sup>145</sup> [1935] S.C.R. 412.

<sup>146</sup> *Supra* note 143.

<sup>147</sup> *Ibid.* at 270.

<sup>148</sup> *Supra* note 113.

<sup>149</sup> *T.S. Taylor Machinery Co. v. Bigger* (1968), 67 W.W.R. 246 (Man C.A.), *Betz Laboratories Ltd. v. Klyn* (1969), 70 W.W.R. 742 (B.C.C.A.) and *Investors Syndicate Ltd. v. Versatile Investment Ltd.* (1983), 149 D.L.R. (3d) 46 (Ont. C.A.).

<sup>150</sup> (2001) 13 C.P.R. (4th) 1 (B.C.S.C.).

of any regional or branch operation of the Purchaser” could be severed so that the geographical scope was limited to British Columbia.<sup>151</sup> Similarly, the severability of a geographic boundary for a restrictive covenant was considered in *Sterling Fence Co. v. Steelguard Fence Ltd.*,<sup>152</sup> where the court severed from the covenant the geographical areas that made the covenant unreasonable and retained those that were reasonable.<sup>153</sup>

In summary, in order to obtain the maximum benefit of restrictive covenants employers should consider drafting covenants so that each provision constitutes a separate and distinct part, enabling offensive portions to be severed by the courts without invalidating the entire covenant. As noted above, there is no guarantee that the courts will entertain the process of severance, but it is more likely than the alternative of reading down a restraint.

### *(b) Implied Terms and Equitable Duties*

In addition to severance and reading down, the courts may look beyond the written terms of the contract. Protection may be obtained by: (i) implying contractual terms; (ii) finding that a collateral contract was formed in addition to the agreement in question; and (iii) imposing obligations founded in tort or equity.

A court will consider implying terms in several circumstances. In the Supreme Court of Canada decision in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*,<sup>154</sup> Iacobucci J. summarized those circumstances by citing the leading Canadian case on implied terms as follows:

[T]erms may be implied in a contract: (1) based on custom or usage; (2) as the legal incidents of a particular class or kind of contract; or (3) based on the presumed intention of the parties where the implied term must be necessary “to give business efficacy to a contract or as otherwise meeting the ‘officious bystander’ test as a term which the parties would say, if questioned, that they had obviously assumed”.<sup>155</sup>

Courts have found implied terms in accordance with these

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<sup>151</sup> *Ibid.* at para. 86.

<sup>152</sup> [1992] B.C.J. No. 2302 (S.C.) (Q.L.). In this case, the geographical scope of the covenant included British Columbia, Alberta, Saskatchewan, Manitoba, and the State of Washington.

<sup>153</sup> *Ibid.*

<sup>154</sup> [1999] 1 S.C.R. 619.

<sup>155</sup> *Ibid.* at para. 27 citing Le Dain J., for the majority, in *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711.

principles, for example, to impose upon an employee an obligation of confidentiality where the restraint on his use of confidential information was found to be void.<sup>156</sup> A court will not, however, imply terms that are not obvious or that contradict those to which the parties have expressly agreed.<sup>157</sup>

It is also open to a court to find that there was a collateral contract containing provisions applying to the employment relationship, including restraints on former employees. However, a court is very unlikely to use this method to supplement the terms of an existing written agreement.<sup>158</sup> This concept is therefore of limited benefit where employers have required an employee to enter an agreement regarding the employee's use of confidential information, solicitation of customers or former colleagues, or competitive activities.

More useful to an employer seeking to protect its interest in customers or confidential information is the court's ability to apply appropriate equitable doctrines. This has allowed courts to impose fiduciary duties and equitable obligations of confidence in addition to those obligations arising from the contractual relationship of the parties, effectively replacing agreements that have been held void as being in restraint of trade.<sup>159</sup>

#### *4. Claw-backs of Stock Options and Other Non-Salary Forms of Compensation*

Making non-competition a condition for receiving some form of additional compensation appears to avoid issues with the restraint of trade doctrine. Several Ontario cases suggest that this approach is much less open to challenge on such grounds.

In *Inglis v. Great West Life Assurance Co.*,<sup>160</sup> the Ontario Court of Appeal upheld a clause which said that a life insurance agent forfeited his right to commissions if he became "connected with" or did

<sup>156</sup> *Wessex Dairies Ltd. v. Smith*, [1935] 2 K.B. 80 (C.A.).

<sup>157</sup> *Potters-Ballotini Ltd. v. Weston-Baker* (1973), [1977] R.P.C. 202 (C.A.).

<sup>158</sup> G.H.L. Fridman, *The Law of Contract*, 4<sup>th</sup> ed. (Scarborough: Carswell, 1999), citing *Bauer v. Bank of Montreal*, [1980] 2 S.C.R. 102, *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515, and *Carman Construction Ltd. v. Canadian Pacific Railway*, [1982] 1 S.C.R. 958.

<sup>159</sup> See, e.g., *Peter Pan Manufacturing Corp. v. Corsets Silhouette Ltd.*, [1963] 3 All E.R. 402 (Ch.D.), *Investors Syndicate Ltd. v. Versatile Investments Inc.* (1982), 126 D.L.R. (3d) 451 (Ont. H.C.J.), rev'd on other grounds (1983), 42 O.R. (2d) 397 (C.A.), and *International Corona Resources Ltd. v. LAC Minerals Ltd.*, *supra* note 15.

<sup>160</sup> [1941] O.R. 305 (C.A.).

<sup>161</sup> *Ibid.* at p. 309.

“business directly or indirectly for” another life insurance company.<sup>161</sup> The Court held that the clause was not in restraint of trade because the employee “was not thereby precluded from himself cancelling the agreement or from going anywhere and doing anything he chose to do, and there was no restraint of any kind on his activities.”<sup>162</sup>

The same reasoning has been applied in the context of retirement benefits. In *Woodward v. Stelco*,<sup>163</sup> the employee entered an agreement under which he was paid a monthly benefit as consideration for not competing with or working for a competitor of his employer. The court held that the agreement, which allowed the employer to discontinue paying the benefit if the employee competed with the employer, was not void as being in restraint of trade.

Finally, in the recent case of *Nortel Networks Corp. v. Jervis*,<sup>164</sup> an Ontario Court upheld a provision in a stock option plan that required the employee to disgorge profits from the exercise of options if he joined a competitor within a specified period after the exercise of the options. The Court held that this provision was not in restraint of trade because it did not prevent the employee from competing.

Although this kind of provision is not likely to run afoul of the restraint of trade doctrine, a different hurdle must be overcome. A court will also consider whether the clause is a penalty. A penalty will not be enforced if it is oppressive.<sup>165</sup> In determining whether a clause is oppressive, the court will consider the employee’s sophistication and whether the penalty reflects the compensation plan’s cost to the employer and the corresponding benefit to the employee.<sup>166</sup>

#### *IV. The Employee’s Departure*

The employee’s and employer’s rights and obligations are largely established when employment begins either through the implied terms that govern the employment relationship, or through the express terms of an employment agreement and related contracts. Some useful steps can be taken at the close of the employment relationship, however, to ensure that the rights and obligations of each party are respected afterwards.

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<sup>162</sup> *Ibid.*

<sup>163</sup> *Supra* note 138.

<sup>164</sup> (2002), 18 C.C.E.L. (3d) 100 (Ont. S.C.J.).

<sup>165</sup> *Ibid.* at p. 108.

<sup>166</sup> *Ibid.*

### A. *Certificate of Compliance*

A seldom used but useful tool to fortify the employer's protection against competition and the misuse of proprietary information is the certificate of compliance. This document is signed by the employee on departure, and acknowledges that the employee continues to be bound by each agreement he or she entered into with the employer at the beginning of the employment relationship.<sup>167</sup>

The certificate should list important pieces of confidential information to which the employee had access, as well as the functions of the employee that were connected with the employer's confidential information. It should also detail any activities that are restrained under the employment agreement or any ancillary agreements. As noted above, the process of listing confidential information to which an employee will be exposed and the precise activities in which he or she will be engaged during employment may be difficult at the time a confidentiality, non-competition or non-solicitation agreement is made. However, the salient items of information are relatively simple to discern in retrospect, when employment ends.

The legal effect of the certificate of compliance itself is not as important as the effect it will have on a court's treatment of the information and activities to which it refers. The certificate of compliance is entered without consideration, and thus may not be enforceable. However, at least one American authority has held that using a certificate of compliance may allow the court to characterize the information listed in it as meeting the threshold required for the court to protect such information as confidential.<sup>168</sup>

### B. *Other Exit Procedures*

Among the other steps that may be taken on the departure of an employee are exit interviews, pre-departure electronic audits and stepped-up monitoring, and a strategic assessment by management or the human resources department.

An exit interview can be used in a manner similar to a certificate of compliance; the employer can take the opportunity both to remind the employee of his or her obligations, and discreetly gather information about the employee's future employment plans and past practices in relation to confidential information and other sensitive activities. This process is aimed at discerning potential problems with the employer's

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<sup>167</sup> Brait, *supra* note 7.

<sup>168</sup> *Telex Corp. v. International Business Machines Corp.*, 367 F. Supp. 258 (N.D. Okla. 1973), *rev'd* on other grounds 510 F. 2d 894 (10<sup>th</sup> Cir. 1975).

systems or with the employee's future activities.

Another common approach used by companies is to have a human resources professional, in conjunction with the departing employee's manager, complete an exposure assessment form, which addresses questions such as "How would you describe the 'overall risk' associated with the departure of this employee?", "Did the employee have access to trade secrets and/or confidential technical information and/or knowledge of corporate opportunities?" and "Would you say that it will be difficult or impossible for the employee to carry out his/her new responsibilities/functions without resorting to the use or disclosure of confidential information or trade secrets of the company?"

When particularly sensitive departures occur it can be advisable to have a lawyer interview the departing employee and address such questions as "What product or market space is your new employer targeting", "What will be your duties in your new position and how do they compare to your old duties at our Company?", "What are your plans with regard to protecting our Company's trade secrets, other confidential information or proprietary information, and corporate opportunities, and how will you ensure that this information is not used or disclosed for the benefit of your new employer?" This practice can be quite effective in reinforcing the seriousness of the situation to the employee. To ensure that all the appropriate questions are asked, use of a script or checklist for such an interview is advisable.

If the employer knows that the employee plans to leave, stepped-up electronic audits of the employee's email and Internet use might be appropriate. Before his or her departure the employee might be planning to engage in a competing business or activity and might have already begun to compete with the employer. These procedures should be addressed in the employer's e-mail and Internet use policy.<sup>169</sup> If illegitimate transfers of information or attempts to intercept corporate opportunities are detected this may be cause for dismissal and for remedies against the employee and others, but merely the intent to compete after terminating employment will not generally be cause for dismissal.<sup>170</sup>

Another useful practice is the maintenance of a database of departing employees. This will be useful in detecting patterns of re-employment with competitors - information that may help to prevent future breaches of confidentiality and non-competition. Further, knowing the competitors (and the positions within those competitors)

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<sup>169</sup> See "Email and Internet Policies" above.

<sup>170</sup> *Zesta Engineering Ltd. v. Cloutier*, (2001), 7 C.C.E.L. (3d) 53 (Ont. S.C.J.).

where former employees are currently, or have been, employed will be extremely useful to the employer in assessing and preparing for potential trade secret or patent litigation against a competitor. For example, if a former employee was an inventor or otherwise involved with specific patents, it would be appropriate to examine the products on which he is working for his new employer, for infringement of those patents.

### *C. Notification to the New Employer*

For the reasons noted above, an employer might wish to notify the departing employee's future employer of the employee's knowledge of confidential information. The notification will displace any assumption that the new employer is an innocent third party and make it liable from the outset for any misuse. In addition, it will foreclose the new employer from arguing the defence of change of position.<sup>171</sup>

The potential benefits of sending a notification should be weighed against the fact that the notice will make the new employer fully aware of the employee's knowledge of confidential information and of the possibility of using it.<sup>172</sup> The risk of notifying the new employer may not be worth taking in some cases since innocent users of confidential information (such as new employers that have not been notified that information is confidential) may nevertheless be liable for damages to the former employer.<sup>173</sup>

The primary purpose of the notice to the new employer is to provide evidence (i) that the new employer was told that the employee knows confidential information, and (ii) of the time at which the employer was told. Thus, the notice should be in writing, and should be delivered in a manner that establishes the time of delivery, such as by personal service or registered mail.<sup>174</sup> To establish exactly what the new employer was told, the notice should contain (i) a statement of the employee's knowledge of certain trade secrets; (ii) an explanation of the employee's continuing obligation to maintain the confidentiality of that information; (iii) a statement of the previous employer's rights in the information; and (iv) a statement that the previous employer will pursue its legal rights.<sup>175</sup>

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<sup>171</sup> Richard A. Brait, "The Unauthorized Use of Confidential Information" (1988) 5 Can. I. P. Rev. 180, cited in Brait, *supra* note 7.

<sup>172</sup> Brait, *supra* note 7.

<sup>173</sup> See, e.g., *57134 Manitoba Ltd. v. Palmer* (1989), 37 B.C.L.R. (2d) 50 (C.A.).

<sup>174</sup> Brait, *supra* note 7.

<sup>175</sup> *Ibid.*

### V. Injunctive Remedies

Where an employee has breached the obligation to maintain information in confidence, or is engaged in competitive activities, harm to the former employer can quickly become irreversible. The employee and his new employer are likely to put information and customer contacts to competitive use as soon as possible in order to profit while the information and contacts still have value. As such, the primary judicial tool relied upon by employers in such circumstances is the interlocutory injunction.

This tool will be discussed generally below. In addition, some attention will be given to the doctrine of inevitable disclosure, which, where applied, has eased the evidentiary burden on employers seeking injunctions in the United States, and to the “springboard” doctrine, which can provide relief to employers even where some of their confidential information has become public.

#### A. General Principles of Interlocutory Relief

Courts may grant injunctions restraining action (prohibitive injunctions) or compelling action (mandatory injunctions).<sup>176</sup> An interlocutory injunction permits an applicant to restrain or compel certain activity before trial. As suggested above, this form of injunction is often the only effective remedy for breaches of confidence and the commencement of competitive activities by former employees.

Typically, an applicant would seek a mandatory injunction for the return of property of a confidential nature (such as mailing lists, software, pricing documentation, or design schematics), and would seek a prohibitive injunction if it sought to restrain a former employee from competing with it, from making improper use of its confidential information, or from soliciting its customers or other employees.<sup>177</sup>

In *RJR-Macdonald Inc. v. Canada (Attorney General)*,<sup>178</sup> the

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<sup>176</sup> Stuart McCormack, ed., *Intellectual Property Law of Canada* (New York: Juris Publishing, Inc., 1999) at pp. 9-35.

<sup>177</sup> Exx: *ITMG-Internet Training & Marketing Group Inc. v. Maksymec* (1997), 157 Sask.R. 83 (Q.B); *Jockey Club Ltd. v. Byrne* (1969), 6 D.L.R. (3d) 600 (Ont. H.C.J.); *Turbo Resources Ltd. v. Gibson* (1987), 60 Sask. R. 221 (C.A.); *Seaward Kayaks Ltd. v. Ree* (2000), B.C.S.C. 1742; *Vita-Tech Canada Inc. v. Healthgene Corp.*, [2000] O.J. No. 2794 (S.C.J.) (Q.L.); *Messa Computing Inc. v. Phipps*, [1997] O.J. No. 4255 (Gen. Div.) (Q.L); *Busnex Busines Exchange Ltd. v. Reimer* (1996), 67 C.P.R. (3d) 164 (B.C.S.C.).

<sup>178</sup> [1994] 1 S.C.R. 311.

<sup>179</sup> [1975] AC 396 (H.L.).

Supreme Court of Canada adopted a three-part test, similar to the test set out in the House of Lords decision in *American Cyanamid v. Ethicon*,<sup>179</sup> to determine when an interlocutory injunction will be granted. The following criteria must be met under the test: (i) a limited review of the case on its merits must disclose that there is a serious issue to be tried; (ii) it must be shown that if the injunction were refused, the applicant would suffer irreparable harm (*i.e.*, harm that could not be remedied at the time of a decision on the merits); and (iii) it must be shown that the balance of convenience favours granting the injunction.

With respect to the first part of the test, the threshold for establishing a “serious question to be tried” is low, and requires only a preliminary examination of the merits of a case. This part of the test is satisfied if a court finds that the application is neither vexatious nor frivolous.<sup>180</sup>

Courts have modified the first part of this test in certain circumstances. For example, where a mandatory injunction is sought, the first part of the test may be more onerous for the applicant, and he may be required to demonstrate a strong *prima facie* case. Other circumstances where this more stringent test is applied include cases where an interlocutory injunction would effectively put an end to the case, where the applicant is seeking to enforce a covenant in restraint of trade, where the only issue involved is a question of law, and where the facts are not in dispute.<sup>181</sup>

Where there is a clear breach of a restrictive covenant or flagrant misappropriation of confidential information, courts have, in some instances, granted injunctions without applying the second and third elements of the test.<sup>182</sup> However, the granting of an interlocutory

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<sup>180</sup> For example, in *Vita-Tech Canada Inc. v. Healthgene Corp.*, *supra* note 177, a case in which former employees were accused of unlawfully soliciting their former employer’s customers and employees, the court noted that it was “unclear” and “arguable” whether these former employees were fiduciaries. The court nonetheless concluded that there was a serious question to be tried.

<sup>181</sup> Christopher Gora *et al.*, “An inquiry into the framework for the award of interlocutory injunctions in intellectual property matters at the Federal Court of Canada” (1997) 76 Can. Bar Rev. 396 at 400; Barry B. Sookman, *Computer, Internet & Electronic Commerce Law* (Toronto: Carswell - Thomson Professional Publishing, 1991) at 4-98.1; *Sheehan & Rosie Ltd. v. Northwood*, [2000] O.J. No. 716.

<sup>182</sup> Sookman, *ibid.* at 4-101 to 4-102.

<sup>183</sup> Jeffrey B. Berryman *et al.*, *Remedies: Cases, Materials, and Commentary*, 4<sup>th</sup> ed. (Toronto: Emond Montgomery Publications Limited, 2001) at p. 864. For example, in *Windship Aviation Ltd. v. deMeulles* (2002), 5 Alta. L.R. (4<sup>th</sup>) 133 (Q.B.), the court required that an applicant seeking an interlocutory injunction on the strength of a restrictive covenant demonstrate that it had a *prima facie* case on the merits, and found

injunction as a means of enforcing a restrictive covenant can result in an employee being without work. Hence, some courts have maintained the stricter requirement that the applicant for an interlocutory injunction establish a *prima facie* case.<sup>183</sup>

The second part of the *RJR-MacDonald* test is often the most difficult part for an applicant to satisfy.<sup>184</sup> In order to show that irreparable harm would occur, evidence of the following will assist the applicant: loss of market share; the necessity of the exclusivity of the proprietary right to the success of its business; evidence that inferior wares produced by the respondent are being confused with wares of the applicant; and the respondent's inability to pay damages.<sup>185</sup>

The third part of the test involves "a determination of which of the two parties will suffer the greater harm from the granting or refusal of an interlocutory injunction, pending a decision on the merits."<sup>186</sup> A

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that the applicant failed to establish this given that it was arguable whether the applicant had just cause to terminate and therefore arguable whether the restrictive covenant still bound the respondent.

<sup>184</sup> W. Lee Webster, "What to do When Things go Wrong: Remedies for Breach of IT Contracts" (paper presented to the Canadian IT Law Association, 27 April 2001) [unpublished].

<sup>185</sup> Diane E. Cornish, "'Clear and Not Speculative' Evidence of Prospective Harm: The Conundrum of Proving Irreparable Harm" (1994) 10 C.I.P.R. 589, cited in Webster, *ibid.* In *Provincial Plating Ltd. v. Steinkey* (1997), 162 Sask. R. 241 (Q. B.), for example, the court found that the applicant's substantial loss of sales, customers and goodwill as a result of a former employee's solicitation of the applicant's customers, as well as the respondent's inability to pay a substantial judgment at trial, were sufficient grounds for a finding of irreparable harm. In *Scantron Corp. v. Bruce*, *supra* note 41, the court observed that potential loss of market share can be grounds for interlocutory relief. The court also recognized that loss of market share can affect the balance of convenience, so that a large company may be granted an injunction against a considerably more fledgling company.

<sup>186</sup> *Manitoba (Attorney General) v. Metropolitan Stores (MTS) Ltd.*, [1987] 1 S.C.R. 110 at para. 35. The concept of relative harm can have a significant effect. For example, even where former employees have wilfully disregarded a non-competition clause knowing that they are risking litigation, the lack of comparable alternative employment outside the geographical limits of the clause may be a significant factor resulting in the denial of an injunction. See *Semiconductor Insights Inc. v. Kurjanowicz* (1995), 63 C.P.R. (3d) 532 (Ont. Gen. Div.)

<sup>187</sup> *Canadian Broadcasting Corp. v. CKPG Television Ltd.* (1992), 64 B.C.L.R. (2d) 96 (C.A.). For example, it has been suggested that it is in the public interest that a former employer's clients be at liberty to consult competitors and to follow former employees with whom they have established a relationship, particularly in the absence of an employment contract prohibiting former employees from contacting their former employer's clients. *R.T. Investment Counsel Inc. v. Werry* (1999), 46 B.L.R. (2d) 66 (B.C.S.C.).

court may consider such factors as the adequacy, measurability and availability of damages if the final outcome reverses the decision made at the interlocutory stage, the preservation of contested property, which of the two parties has acted to effect the *status quo*, the strength of the applicant's case, and the public interest.<sup>187</sup> A court may also consider whether the applicant has been slow to take steps to obtain injunctive relief and may consider the relative economic circumstances of the parties.<sup>188</sup>

In addition to the general distinction between prohibitive and mandatory injunctions, there are two special types of interlocutory injunctions. First, where there is a genuine risk that the defendant's assets may disappear, so that any recovery at trial would be ineffectual, an applicant may seek a *Mareva* injunction, which prevents the defendant from removing his or her assets from the jurisdiction.<sup>189</sup> Second, where a defendant might destroy or conceal evidence of its wrongdoing that it solely possesses, an applicant may apply *ex parte* for an *Anton Piller* order. Under this order, the applicant can require the defendant to make available for the applicant's inspection articles and documents relevant to the proceedings.<sup>190</sup>

## B. The Inevitable Disclosure Doctrine

### 1. American Jurisprudence

The doctrine of inevitable disclosure was developed in U.S. employment law jurisprudence. It is used in cases where there is a high probability that an employee who has left one company and assumed a similar role in a competitor company, will disclose confidential information that he or she obtained during employment with the former employer. When applicable, the doctrine may prevent the employee from assuming the new role.

Although the courts have not consistently used the same analytical framework when applying the doctrine, generally a four part test has been applied. The departing employee must be in possession of trade secrets of the former employer. He or she must be taking new employment with a competitor of the former employer. His or her new

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<sup>188</sup> *Provincial Plating Ltd. v. Steinkey*, *supra* note 185. For example, in *Hudson's Bay Co. v. McClocklin*, *supra* note 86, the court, in deciding to grant an interlocutory injunction restraining a former employee from soliciting clients of his former employer, observed that the plaintiff might otherwise suffer serious harm not compensable by damages, whereas the defendant's business should, on the facts, still be viable.

<sup>189</sup> McCormack, *supra* note 176 at pp. 9-40 to 9-41.

<sup>190</sup> *Ibid.* at 9-42.

position should involve responsibilities that are substantially similar to the former employment. Finally, the former employee must be either unable or unwilling to avoid relying on the former employer's trade secrets to the former employer's detriment, and the new employer must have failed to provide adequate protections against such reliance.

The cornerstone of the doctrine is that it allows a plaintiff to avoid having to prove a breach of confidence by instead showing that the disclosure of information under the circumstances is inevitable. This principle is outlined in *Eastman Kodak Co. v. Powers Film Products Inc.*,<sup>191</sup> an early case applying the doctrine. In that case, an employee of Kodak left to work for a competitor. Though the court was not presented with any evidence that the departing employee actually misappropriated any of Kodak's trade secrets, the court granted an injunction against the employee because "[T]he mere rendition of the service along the lines of his training would almost necessarily impart such knowledge to some degree."<sup>192</sup>

The groundwork for the modern form of the inevitable disclosure doctrine was laid by the adoption, by a majority of U.S. states, of the *Uniform Trade Secrets Act*,<sup>193</sup> which provides for broad injunctive relief to remedy both actual and threatened misappropriation of trade secrets.<sup>194</sup> Among the first judicial treatments of the *UTSA* was *PepsiCo v. Redman*.<sup>195</sup> In that case, the Court of Appeals for the 7<sup>th</sup> Circuit upheld a preliminary injunction enjoining a management level employee from working for a direct competitor for six months, on the grounds that the employee could not avoid making decisions about the new employer's products relying on his knowledge of his former employer's trade secrets.<sup>196</sup> In making its decision, the court also considered the fact that the employee had signed a confidentiality agreement acknowledging his access to trade secrets, that the former and new employers were direct competitors, that the employee had similar duties with each employer, and that the employee had not been candid with his former employer.<sup>197</sup>

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<sup>191</sup> 179 N.Y.S. 325 (App. Div. 4<sup>th</sup> Dept. 1919).

<sup>192</sup> *Ibid.* at 330, cited in Michael Starr and Adam S. Blank, "Why the fuss over 'inevitable disclosure'?" (12 March 2001) 225:47 *New York Law Journal* 11.

<sup>193</sup> [*UTSA*].

<sup>194</sup> David J. Carr, ed., "A Tale of Two Cities: The Doctrine of 'Inevitable Disclosure'" online: ABALabor and Employment Law Section – BNA Books <<http://www.bna.com/bnabooks/ababna/rnr/98/rrcarr.pdf>> (date accessed: 26 September 2002).

<sup>195</sup> 54 F. 3d 1262 (7<sup>th</sup> Cir. 1995) (Considering the *Illinois Trade Secrets Act*).

<sup>196</sup> *Ibid.* at 1269.

<sup>197</sup> Carr, *supra* note 194 at p. 4.

There is considerable controversy surrounding the doctrine, and considerable variation among U.S. courts in their acceptance of it.<sup>198</sup> There is also significant variation across jurisdictions in the United States in the application of the four part test, particularly the first and fourth parts of the test. For instance, with respect to the first part of the test – the requirement that the former employee be in possession of trade secrets of the former employer – cases such as *Pepsico* suggest that the existence of a confidentiality agreement supports the application of the doctrine, since such an agreement demonstrates that the employer has taken “reasonable steps to maintain the confidentiality of the information at issue...”.<sup>199</sup> Similarly, an employer’s failure to enter into a non-competition agreement with its employee may weigh against the application of the doctrine since it indicates a lack of concern for the disclosure of the information.<sup>200</sup> However, in other cases, such as *PSC Inc. v. Reiss*,<sup>201</sup> and *EarthWeb v. Schlack*,<sup>202</sup> the courts have held that the existence of a confidentiality agreement mitigated against the applicability of the doctrine of inevitable disclosure.<sup>203</sup> In particular, the court in *EarthWeb* expressed concern that supplementing an existing confidentiality agreement with the doctrine of inevitable disclosure would have the effect of imposing a restrictive covenant that was not the product of open negotiation.

With respect to the second and third parts of the test, it seems clear that, at the very least, the mere fact of working for a competitor is insufficient.<sup>204</sup> However, what a court will accept as being a sufficient degree of similarity in job responsibilities varies from case to case.

With respect to the fourth part of the test – the former employee’s inability or unwillingness to avoid relying on the former employer’s trade secrets to the former employer’s detriment, and the new

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<sup>198</sup> See, e.g., *Electro Optical Indus., Inc. v. White*, 76 Cal. App. 4th 653 (1999), where the California Supreme Court “depublished” a lower court’s decision endorsing the doctrine.

<sup>199</sup> Robert T. Quackenboss, “Injunctive Relief Denied in Cases Involving Inevitable Disclosure Doctrine,” online: The National Law Journal (22 June 2001) <[http://www.hunton.com/pdfs/article/quackenboss\\_Injunctive\\_Relief.pdf](http://www.hunton.com/pdfs/article/quackenboss_Injunctive_Relief.pdf)> (date accessed: 2 October 2002).

<sup>200</sup> Carr, *supra* note 194 at p. 11.

<sup>201</sup> 111 F. Supp. 2d 252 (W.D.N.Y. 2000).

<sup>202</sup> 71 F. Supp. 2d. 299 (S.D.N.Y. 1999).

<sup>203</sup> See Starr and Blank, *supra* note 192 at p. 4 and Carr, *supra* note 194 at p. 3.

<sup>204</sup> See, e.g., *Century Personnel, Inc. v. Brummett*, 499 N.E. 2d 1160 (Ind. App. 1986).

<sup>205</sup> See, e.g., Megan P. Frient, *Inevitable Disclosure: An Ohio Court Recognizes the Doctrine* online: Thompson Hine Report <[http://www.thompsonhine.com/news/nl/compet\\_April2001.php](http://www.thompsonhine.com/news/nl/compet_April2001.php)> (date accessed: 7 July 2004).

employer's failure to provide adequate protections against such reliance – there is no consensus as to whether there is a threshold requirement that the former employee or new employer must have the intention to misappropriate confidential information.<sup>205</sup> Also, with respect to detriment to the employer, some cases restrict the applicability of the doctrine by requiring that the “calculus of harms” favour the former employer's interest in protecting confidential information over the former employee's interest in obtaining new employment.<sup>206</sup>

Sufficient judicial consideration of the doctrine exists to allow some generalizations to be made about what circumstances are associated with successful applications for “inevitable disclosure” injunctions, and what circumstances are associated with failed applications. For instance, with respect to the first part of the test, a threshold requirement is that the employee must possess sufficiently important confidential information. Amongst other factors, courts may consider to what extent the information was known to those outside and within the former employer's business, the amount of time, effort, and money spent by the former employer to develop the information, and the ease or difficulty with which a competitor could acquire or develop the information.<sup>207</sup> With respect to the fourth part of the test, the courts are more likely to apply the doctrine if the former employer can show that the threatened misappropriation will result in damages that cannot be compensated by a monetary award.<sup>208</sup>

## 2. Canadian Jurisprudence

The doctrine of inevitable disclosure has not yet become an accepted construct in Canadian jurisprudence. However, the case law suggests that it might be applied if the appropriate circumstances arise.

The first Canadian case to address the doctrine of inevitable disclosure was *ATI Technologies Inc. v. Henry*.<sup>209</sup> In that case, the court observed that there is no Canadian case in which the doctrine of inevitable disclosure has been applied. The court noted that, while the doctrine has been used sparingly in a few American cases, American jurists and commentators appear to view it sceptically. However, in declining to apply the doctrine, the court pointed to the fact that the

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<sup>206</sup> Carr, *supra* note 194 at pp. 5 and 11.

<sup>207</sup> Matthew K. Miller, “Inevitable Disclosure Where No Non-Competition Agreement Exists: Additional Guidance Needed” 10:1 *Journal of Science and Technology Law*, online <<http://www.bu.edu/law/scitech/volume6/Miller.htm>> (date accessed: 26 September 2002).

<sup>208</sup> Carr, *supra* note 194 at p. 8.

<sup>209</sup> (2000), 5 C.C.E.L. (3d) 101 (Ont. S.C.J.).

doctrine appeared to be applied only where the former employee's trustworthiness was suspect. In *Graphiques Matrox inc. c. nVidia Corp.*,<sup>210</sup> the Cour Supérieure du Québec held that while the doctrine did not apply when dealing with low-level employees such as security guards or administrative staff, it might apply to high-level employees such as engineers or managers.

A more conservative view of the doctrine is found in *Future Shop Ltd v. Northwest-Atlantic (B.C.) Broker Inc.*<sup>211</sup> There, the court suggested that the application of the doctrine of inevitable disclosure, even without the distinguishing finding of bad faith, would require a significant change in the tests applicable in Canada.

### C. The Springboard Doctrine

As mentioned above, the springboard doctrine stipulates that a person who receives confidential information by virtue of his or her relationship (e.g., an employee) may not use that information to gain an unfair advantage in the marketplace to the detriment of the confider (such as an employer). The doctrine applies even if all elements of the confidential information are publicly available, so that a member of the public could reach the same result by a process of reverse engineering.<sup>212</sup> In these circumstances, the former employee may be enjoined from using the information where the information gives him or her a head start over members of the public by eliminating or reducing the time and effort involved in independently compiling the information.<sup>213</sup> Also, where the information is partly public and partly private, the doctrine may apply where the employee is in a better position than if he or she had relied only on the public component of the information.<sup>214</sup>

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<sup>210</sup> [2001] J.Q. no 3344 (C.S.).

<sup>211</sup> 2000 B.C.S.C. 1797.

<sup>212</sup> *Terrapin Ltd. v. Builders' Supply Co. (hayes) Ltd.*, *supra* note 29; *Lake Mechanical Systems Corp. v. Crandell Mechanical Systems Inc.* (1985), 7 C.P.R. (3d) 279 at 284 (B.C.S.C.); *Schauenburg Industries Ltd. v. Borowski*, *supra* note 15; and *Eli Lilly Canada Inc. v. Shamrock Chemicals Ltd.* (1985), 4 C.P.R. (3d) 196 at 198 (Ont. S.C.).

<sup>213</sup> *Ken Graham Products v. Sunbeam Corp.*, *supra* note 33; Robert Howell, "Database Protection and Canadian Laws" (15 June 1998) online: Industry Canada <<http://www.pch.gc.ca/progs/ac-ca/pubs/ic-ci/pubs/fulveren.pdf>> (date accessed 7 July 2004).

<sup>214</sup> *Seager v. Copydex, Ltd.*, [1967] 2 All E.R. 415 at 417 (C.A.); *International Corona Resources Ltd. v. LAC Minerals Ltd.* (S.C.C.) *supra* note 15; *Sante Naturelle Ltee c. Les Produits de Nutrition Vitaform Inc.* (1985), 5 C.P.R. (3d) 549 at 555 (Que. S.C.); *Lake Mechanical Systems Corporation v. Crandell Mechanical Systems Inc.*, *supra* note 212 at pp. 284-87.

However, even where the circumstances of a case suggest that a former employee may be in a position to use a former employer's confidential information as a springboard for activities detrimental to the former employer, courts will not inevitably grant an injunction. In determining whether to apply the springboard doctrine to grant an injunction, a court will apply the test governing the granting of injunctions generally, as discussed above. Beyond this, the courts will consider such factors as the relative strength in the industry of the employer and the employee/new employer, whether the information is easily ascertained or has since become public knowledge, and the level of secrecy with which the parties have treated the confidential information.<sup>215</sup>

The Supreme Court of Canada recently considered the nuances of the springboard doctrine in *Cadbury Schweppes Inc. v. FBI Foods Inc.*<sup>216</sup> The case involved an appeal by the defendant of a damage award and of a permanent injunction enjoining the defendant's use of the plaintiff's confidential information. The Court noted that equity has set a relatively low threshold for the types of information that will be afforded protection as "confidential". In that case, the information at issue involved the manufacturing processes for the trademarked beverage "Clamato". The trial judge had found that considerable changes in the ingredients and process could be made without any significant effect on the nature of the end product.

The Supreme Court did not uphold the injunction, observing that the confidential information was "nothing very special," and noting the trial judge's finding that the defendants were able to approximate the taste of Clamato without ever having had access to the secret "dry mix", and that this approximation was sufficient for commercial purposes. However, the Court also agreed with the trial judge that the breached confidences had acted as a springboard to enable the defendants to bring their product to market twelve months earlier than would otherwise have been the case. The Court thus assessed damages at the value of the lost market opportunity of being able to market Clamato free of the defendants' competition for twelve months. In imposing this twelve month limit, the Court thus tempered the effect of the low threshold for finding that information is confidential.

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<sup>215</sup> *Applied System Technologies Inc. v. Sysnet Computer Systems, Inc.* (1991), 40 C.P.R. (3d) 405 (Ont. Ct. (Gen. Div.)); additional reasons at (1992), 41 C.P.R. (3d) 129 (Ont. G.D.); *Sante Naturelle Ltee., ibid*; *Unicare, Inc. v. Thurman* (1978), 41 C.P.R. (2d) 97 (Ont. H.C.J.).

<sup>216</sup> *Supra* note 29.

## *VI. Conclusion*

The common law is often insufficient to protect employers against the risks of former employees disclosing confidential information and competing. This is especially true for employers in the technology industries, whose competitiveness depends on their confidential information and intellectual property.

At the outset of the employment relationship, written agreements about the use of confidential information and the ownership of intellectual property, conflicts of interest, and the use of email and the Internet, protect the employer's interests. These agreements reinforce, and can also extend, the employer's common law rights.

These agreements can also affect the parties' post-employment rights and obligations insofar as they restrain the employee's activities after employment. The temptation to place restraints on employees will be naturally tempered by the cost of preparing detailed agreements for large numbers of employees. However, employers should not, in addition, be entirely dissuaded by fear of the court's ability to invalidate such provisions through the restraint of trade doctrine. Rather, where restraints are used (for example, in the case of higher-level employees), attention to detail and careful consideration of the activities that may legitimately be covered by restrictive covenants should be undertaken. The employer should draft covenants with severance in mind, and keep specific and general clauses separate and distinct. If a general non-competition clause is absolutely necessary, it should be kept separate from any non-solicitation clause to avoid both failing together.

In addition, such agreements may be supplemented or replaced, for certain employees, by agreements tying extraordinary compensation to obligations of non-competition. This approach will generally avoid the pitfalls of the restraint of trade doctrine altogether.

Employers should also have in place a procedure to address the departure of employees. This procedure can usefully supplement agreements about post-employment activities. It will also remind the employee and the future employer of the obligations that survive even after employment ends.

The agreements and measures put in place by the employer may, and often do, prove insufficient to prevent an employee from competing with the employer. In such cases, the most likely reaction of

the employer will be to seek an injunction against the employee's competitive activities or disclosure of information.

In seeking injunctions, Canadian employers may be able to have the benefit of the doctrine of inevitable disclosure. However, they will usually be required to prove that an employee has breached the employer's confidence. This requirement highlights the importance of measures that the employer might take during the employment relationship to clarify for the employee (and ultimately the court) what information is confidential.

Finally, employers may take some comfort in the courts' tendency to recognize the commercial realities of the exploitation of confidential information, as reflected in their use of the springboard doctrine. The courts are willing to protect an employer's interest in a broad spectrum of information for a reasonable time even where it has become public knowledge. The employer's challenge is to take steps before the fact that help to identify important elements of its confidential information, and to prevent their disclosure.

