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Employment Agreement Clauses

What would happen if Coca-Cola's "secret formula" were made public?

All businesses have a certain amount of sensitive information that should remain private. In the course of their work, employees often learn or have access to sensitive information about their employers' businesses. This can include trade secrets, financial data, business plans, customer lists, and other confidential or proprietary information. Employees may also cultivate valuable relationships with co-workers and customers. These relationships can be critical to the success of their employers' businesses.

If employees use that sensitive information or their close relationships with co-workers and customers in a manner detrimental to their employers, it can have disastrous and sometimes irreparable consequences. In some cases, if a key employee or several key employees leave and start their own firm or join a competitor, a business may be hard pressed to survive, or maintain its share of the market.

Employers have a legitimate interest in protecting sensitive information and guarding against the loss of customers and other employees. One way employers can protect themselves is by having employees sign employment contracts which contain confidentiality clauses and restrictive covenants. Alternatively, if an employee owes a fiduciary duty to his or her former employer, the employee's conduct may also be restricted.

CONFIDENTIALITY CLAUSES

A confidentiality clause should be carefully drafted to include whatever information is particularly important to the employer. This will vary business to business, but it is important to clearly identify any and all types of information to be considered for inclusion (i.e. trade secrets, financial data, client lists, etc.).

A well-drafted confidentiality clause serves to let an employee know what work-related information he or she can use or disclose. If an employee ever uses or discloses that information inappropriately, an employer can take the employee to court. Courts generally uphold confidentiality clauses and may award compensation and other remedies to the employer (such as an injunction).

It is also important that the definition of confidential information includes certain exemptions. For instance, if information is already publicly known through no fault of the employee, then the employee cannot be prevented from later using or sharing that information. Also, if an employee is ever ordered to give evidence by a court, then that employee may be permitted to disclose confidential information, so long as he or she does not disclose more than is required.

An employee should also be required to return any materials containing confidential information after he or she ceases to work for an employer.

RESTRICTIVE COVENANTS

"Restrictive covenants" literally restrict what a person may do after he or she ceases to work for an employer. To be enforceable, it must be reasonable both between the employer and employee, and with reference to the public interest in having a free, competitive marketplace.

In assessing "reasonableness," courts look at three issues:

1. Does the employer have a legitimate interest entitled to protection?
2. Is the length of time or the geographic area of the restriction too broad?
3. Is the covenant unenforceable - being against competition, and not limited to preventing solicitation of customers or other employees?

The most common restrictive covenants in the employment context are "non-solicitation agreements" and "non-competition agreements."

Non-solicitation agreements should only serve to prevent a former employee from attempts to "hire away" other employees, as well as attempts to "take business" from his former employer by approaching existing (or recent) customers with offers of similar goods or services. It should also have time and/or geographic limits (e.g. valid for a two year period after employee's employment ends, valid within the Province of Ontario).

If a non-solicitation agreement is too broad, then it may be considered a "non- competition agreement." For example, if a former employee cannot contact an existing (or recent) customer, even to offer totally different and non-competitive goods or services from those offered by his or her former employer, then this is unenforceable.

Non-competition agreements can severely limit an employee's ability to find similar work after his or her employment ends. In Canada, courts are generally opposed to non-competition agreements, as they serve to lessen competition. As of October 25, 2021, employers are prohibited from entering into non-competition agreements with employees in Ontario, with certain specified exceptions. However, non-competition agreements entered into prior to October 25, 2021 are not prohibited or voided.

Courts have made it clear that they will only enforce restrictive covenants when they are reasonable in their entirety. Courts will not enforce overreaching terms or interpret ambiguous terms. For this reason, it is very important for employers to review their proposed restrictive covenants with their lawyers.

FIDUCIARY OBLIGATIONS

EMPLOYEE DUTIES

Each employee owes their employer a general duty of good faith and fidelity, regardless of whether a fiduciary relationship exists. This is an implied term of every employment contract and is a necessary concept in employment law to ensure that an employer's and employee's interests are aligned.

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FIDUCIARY DUTIES

Generally, a fiduciary duty requires a person to place another person's interests ahead of their own.

In *Canadian Aero Service Ltd. v. O'Malley*,[1] a leading case on fiduciary duty, the Supreme Court of Canada provided three tests for determining if there is a fiduciary relationship between two persons: (1) the fiduciary has scope for the exercise of some discretion or power; (2) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and (3) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power. This case involved an officer of the company appropriating a corporate opportunity for their own benefit to the exclusion of the company.

One or all of these factors are typically present for a court to find a fiduciary relationship exists between the parties. What is of critical importance is whether one party is dependent on or vulnerable to another party.

Based on the above factors, it is plain to see why a fiduciary relationship can exist between a trustee-beneficiary and agent-principal. It has also been widely understood that directors and officers owe the company's they serve certain fiduciary duties.

FIDUCIARY EMPLOYEES

In recent years, the concept of fiduciary relationships has expanded to find that certain employees owe a fiduciary duty to their employer.

A fiduciary employee is an employee who has a special relationship of trust with his or her employer. They generally possess the ability to exercise unilateral decision-making in ways that affect the employer's interest.

Fiduciary employees have a special obligation to keep confidential their employers' sensitive information, even if they have not signed an agreement. They are obliged not to use or to disclose confidential information or solicit his or her employer's customers or employees.

If an employee owes his or her employer a fiduciary duty, this employee, among other things: (1) is more limited in his or her ability to compete with his or her employer post- employment; and (2) cannot take advantage of a corporate opportunity that ripened during the course of his or her fiduciary employment.

These obligations last for a reasonable time after he or she leaves their role. Even if an employer is probably a fiduciary, you should ensure he or she accepts a well-drafted confidentiality clause in his or her employment agreement.

[1] (1974) SCR 592.

GasTOPS Ltd. v Forsyth[2]

In the case of *GasTOPS Ltd. V Forsyth*, four key employees of GasTOPS gave 2 weeks' notice that they were leaving the company around the same time.

Shortly after their resignation, the ex-employees set up a competing company, MxI Technologies Ltd., and actively solicited clients from their former employer. As a result, GasTOPS lost several current and potential customers. Some of its other employees left to join MxI Technologies Ltd.

The court found that these key employees ultimately breached several fiduciary duties, including a duty not to usurp a business opportunity and a duty not to solicit their employer's customers. The court also found the employees breached their general duty not to appropriate trade secrets or confidential information for their own benefit.

As a result of their breach of fiduciary and general duties, the court held that the four ex-employees and their competing corporation were jointly and severally liable to pay to GasTOPS virtually all the profits they earned over the last 10 years (roughly $12 million) and further awarded costs and pre-judgment interest of nearly $8 million.

Aquafor Beech Limited et al. v Whyte et al.[3]

If *GasTOPS* is a cautionary tale of the danger of employees owing a fiduciary duty to their employers competing directly with their former employer, then *Aquafor v. Whyte* is a case that highlights how it can be done.

In *Aquafor v. Whyte*, Robert Whyte and Bill Dainty were key employees who together accounted for over 25% of Aquafor's revenues.

In 2003, Whyte and Dainty left Aquafor and set up a competing engineering firm. There was no written contract prohibiting Whyte and Dainty from competing or soliciting clients. Therefore, Aquafor was relying on the finding of a fiduciary relationship and the determination that Whyte and Dainty had violated their fiduciary duties by setting up a competing firm that engaged Aquafor's clients.

Although the court held that a fiduciary relationship existed, the court held there was no evidence of unfair competitive practices, even though clients of Aquafor left that company to become clients of Whyte and Dainty's new corporation.

Part of the reason for this finding is that Whyte and Dainty did not actively solicit Aquafor's customers. Although Whyte and Dainty sent a general letter of introduction to their potential customer base at large (including several of the plaintiff's clients), this did not amount to solicitation.

The court held that a client has a right to choose which professional it will rely on for a professional service and that absent misuse of confidential information, there was no reason to preclude Whyte and Dainty from accepting work from former clients.

[2] (2009) OJ No. 3969.

[3] 2010 ONSC, 2733, 102 OR (3d) 139.

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REASONABLE NOTICE

The requirement for employees to give reasonable notice of their resignation, unless a specific time period is contractually stated, is a general employment concept and not necessarily a fiduciary duty.

In *GasTOPS*, the court was also asked to determine whether the length of notice given by the key employees prior to their resignation was reasonable. It found that the notice was insufficient, and that 10 months' notice was more appropriate in the circumstances. The issue of reasonable notice was not raised in the subsequent appeal and so was not explored further. However, the concept of requiring an employee to provide reasonable notice upon resignation is not new.

The issue of reasonable notice was also raised in *Aquafor v. Whyte*: Whyte and Dainty gave 5 weeks' and 4 weeks' notice, respectively.

The court found this notice reasonable, but also pointed out that Aquafor, by its actions, may have actually accepted the notice provided and so could not later claim it was unreasonable.

What constitutes reasonable notice is a matter of fact. It is fair to conclude that the harder an employee is to replace and the more important and unique their position, the more likely the employee will be required to give a longer notice of his or her resignation.

MOVING FORWARD

When hiring key employees or promoting employees to important positions, consider having the employee sign a non-solicitation and confidentiality agreement. Note that a contract is only enforceable when new consideration is provided by an employer to the employee, such as a raise or promotion.

It is also helpful for business owners to periodically assess what would happen if they had to leave the business tomorrow and plan for an ultimate successor. The same assessment should be done with respect to key employees. This is a business's form of 'stress testing'. For further information on succession planning, please see our article HERE.

Finally, if a key employee is resigning, do not immediately accept the notice given as reasonable. Take the time to consult with legal counsel and consider your options, particularly if the employee is important to your operations.

CONCLUSION

If you would like to learn more about confidentiality clauses, restrictive covenants, fiduciary duties, or the importance of employment agreements and reasonable notice, please contact us.

CONTACT

If you would like more information about this or any area of corporate law, please contact us at 416.860.8032 or info@houserhenry.com.

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