Beware of Prospective Employees With Legal Constraints

The Do's and Don 'ts of Hiring from a Competitor

by Alan Riddell, LLB

When hiring employees of a competitor, care should be taken to minimize the chance of legal action taken by the competitor against both you and its former employee. A little foresight can do much to avoid the worry and expense of a long and expensive lawsuit. When you hire one of your competitors' former employees, there are no less than three grounds upon which your competitor can base a potential lawsuit-Breach of Written Covenant If your competitor has a written covenant with its former employee prohibiting that employee from (i) working for you or another competitor, (ii) soliciting its own former clients or (iii) disclosing any allegedly confidential information to you, both you and your new employee may be held liable for any resulting damages suffered by your competitor. In these circumstances, your competitor could also be successful in obtaining an interim injunction preventing you from using its former employee in a way that is useful to your company. As a result, you could find yourself not only havi ng to pay a large sum of money in damages and legal fees, but also saddled with a new, highly paid employee, who is effectively unable to be of any real service to your company.

Not all restrictive covenants exacted by your competitor from its former employees are legally binding. If a court can be persuaded that the restrictive covenant is "unreasonable" in that it goes further than what is strictly necessary to protect your competitor's legitimate proprietary rights, the covenant will be struck down. The question of whether a particular restrictive covenant is so "unreasonable" as to be legally invalid is not easily answered. A court will look to "all the circumstances" of your competitor's business and to the nature of the "proprietary interest" which it seeks to protect through the covenant. Accordingly, a lot of study should be given to the wording of the covenant and the nature of your competitor's "proprietary interest" before jumping to the conclusion that the covenant is invalid and that your company's defiance of the covenant will be excused by a court.

A common, and serious, error made by companies, is to assume that because a competitor's restrictive covenantprohibits a former employee from competing in a large geographic area for several years, the restrictive covenant will necessarily be "unreasonable". The "unreasonable" nature of the covenant depends less on its geographic scope or its duration than on the nature of your competitor's business itself. In one famous case, a court upheld as reasonable, and hence legally binding, a restrictive covenant which prohibited the employee from working for any competitor for many years anywhere in the world. The basis for this decision was that the nature of the company's business (munitions) was worldwide in scope.

Breach of Fiduciary Duty

If the former employee had a "fiduciary" relationship with his former employer, he is prohibited from "unfairly" competing againsthis former employerafterhe leaves his employment, even in the absence of a valid restrictive covenant. This ongoing fiduciary duty also precludes him from taking advantage of any "ripening business opportunity" which might present itself, afterhe leaves, which he may have learned about while working with his former employer. Accordingly, a "Fiduciary" employee who resigns for the purpose of joining a competitor and competing against his former employer may be found to be in

breach of a fiduciary duty to that employer. If so, both the employee and the new employer may be liable to the former employer in damages. For an employee to be a "fiduciary", he must have exercised a certain degree of "independent discretion or power". In addition, the formeremployer must have been "vulnerable", in a business sense, to the actions of the former employee, while on the job.

In attempting to ascertain whether a prospective employee is a "fiduciary" of a competitor, whose hiring makes your company a party to a breach of fiduciary duty, courts will look not so much at the official description or title of his former position as at his routine responsibilities. All too often companies, and their legal counsel, fall into the trap of assuming that simply because a prospective employee is in a junior position with a competitor, it naturally follows that he cannot be a "fiduciary". On the contrary. Courts have held that even salesmen and messengers can be "fiduciaries", and have severely penalized their new employers for hiring them away. Courts throughout Canada's nine common Provinces have held that very low ranking employees who exercise a certain degree of independent discretion and autonomy in their day-to-day dealings with their employer's customers, and who

develop a close relationship with those customers, may in fact, be bound by a fiduciary duty not to solicit customers. In addition, even where a junior employee is not himself a "fiduciary", a court may nevertheless impose fiduciary duties on him either (i) if it is discovered that he did something dishonest prior to leaving his former employer (like taking with him corporate documents or a client list or lying to his former employer about his future job plans) or (ii) if the court finds that he is competing against his former employer in concert with another former employee, who is senior to him, and who is fiduciary.

Accordingly, when hiring an employee away from a competitor it is essential that the following steps be observed:

1. The employee must be told to return all documents and client lists in his possession to his former employer prior to leaving;

2. in the weeks leading up to his departure, the employee must take care not to be seen nosing around his former employer's files, apparently trying to pick-up or memorize valuable client information;

3. The employee must not resign "in concert" with other more senior employees to join your firm: it must not look as though the former "mere" employee is resigning for the purpose of helping the more senior, "fiduciary", employee compete unfairly against their former employer;

4. It is always helpful if the employee has some objective problem which he can point to, in his relations with his former employer, to meet any later accusation that he resigned for the sole purpose of harming his former employer.

Breach of Confidentiality

Even where the employee has signed no valid restrictive covenant, and was not a "fiduciary" of his former employer, he may still be found guilty by leaving his former employer with confidential information and using this as part of and joining your company. If this happens, your company will be jointly liable in damages to his former employer for any sales of products which incorporate, even indirectly, such confidential information.

As a general rule, an employee will be found guilty of breaching his duty of confidentiality if he divulges trade secrets or copies client lists, but not where he uses the skills, general knowledge and personal goodwill which he acquired over the course of his former employment to compete. It is important to note that some courts have held that even where the employee does not take any written corporate document but deliberately memorizes it prior to leaving, he is in breach of his duty of confidentiality. Also, courts have held that an employee may be in breach of his duty of confidentiality simply where he gains knowledge about relatively straightforward technical production processes (which may have only taken a few hours to develop), prior to joining his new employer.

Constraining Factors

> Watch Out For:

Breach of Written Covenant

Breach of Fiduciary Duty

Breach of Confidentiality

If your company hires an employee who has technical knowledge about your competitor's production process, a court may assume that he is divulging this information to you, even though there may be no direct proof that he is, or intends to do so. In this case, both your company and that employee may find themselves with an injunction preventing the employee from working for you altogether. Some courts now distinguish between (i) specific trade secrets and, (ii) information which, although originally confidential when it was imparted to the employee by his former employer, is not "readily separable" from the skills and knowledge acquired by him during the course of his employment. Courts will generally be reluctant to grant an injunction to prevent disclosure of this latter category unless the employee signed a restrictive covenant acknowledging that the information was confidential and promising not to divulge it to any future employer.

Conclusion

The law of restrictive covenants, fiduciary duties and confidentiality is complex and on some issues still obscure. It is never possible to entirely eliminate the risk of a successful lawsuit against your company by a competitor on any of these three grounds. However, if you happen to be the departing employee, and are concerned about a potential lawsuit from your past employer, you should consider the following precautions:

1• If you have signed a restrictive covenant not to compete against your present employer, it would be wise before jumping ship to insist that your new employer give you some guarantee that it will help you with legal costs and continue to employ you in another capacity if a court orders you to refrain from competitive activities for a new employer in your chosen profession.

2. If you have been exposed to confidential information, make it clear to your employer that you will not be taking any of this information with you and also that you will not be using your knowledge of this information when working for a new employer. Make it clear to a prospective employer, before agreeing to join him, that you cannot work in a capacity which will require disclosing or even using this information to compete on his behalf.

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