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In a recent decision of the Ontario Superior Court of Justice, the court ruled that the wrongful termination of a fiduciary employee might relieve that employee from any and all fiduciary duties post termination.

The decision in *Zesta Engineering Ltd. v. Cloutier*, [2001] O.J. No. 621 exposes employers to considerable risk if a fiduciary employee is terminated without cause and without reasonable notice.

## Fiduciary Employees

It is established law in Canada that certain "key" employees owe "fiduciary" duties to their employers. Generally understood, these upper echelon employees are considered "fiduciary" employees because they have the discretion to act unilaterally and to affect the employer's interests through such action. They are therefore considered to hold positions of trust and confidence and, as such, are "fiduciaries."

Because of the significance of the "fiduciary" position, courts have imposed certain implied duties and obligations on fiduciary employees over and above the general implied duties owed by all employees. And because the duties are implied, they bind the fiduciary employee even in the absence of a written employment contract

Post-employment fiduciary duties are particularly critical to the protection of an employer's business interests. For example:

While employees generally have a

duty to respect a former employer's trade secrets and customer lists, a fiduciary employee is also prohibited from directly soliciting the former employer's customers.

i A fiduciary employee is prohibited from soliciting other employees of the former employer in an effort to have them join the fiduciary in a competing venture.

i A fiduciary must not use information gained through employment to take advantage of a business opportunity that is being pursued by his/her former employer.

Thus, while a fiduciary employee is not entirely prohibited from competing (absent a specific contractual limitation), he or she cannot compete through solicitation or by confiscating business opportunities from the former employer.

It is also well-established that post-employment fiduciary duties are time-limited - the fiduciary employee remains bound for such reasonable period of time as would enable the employer to solidify and secure its customer relationships.

However, as a result of the court's decision in *Zesta*, it appears that if an employer wrongfully dismisses a fiduciary employee, that employee may be relieved from any further fiduciary duties to the employer.

In *Zesta*, the court considered a claim by the employer, *Zesta*, against five former senior managerial employees. *Zesta* terminated the employment of these employees, alleging cause on the grounds that they were planning to set up a new company in direct competition with *Zesta* by using *Zesta's* confidential information and soliciting *Zesta's* customers.

Following the terminations, *Zesta* sought injunctions and damages against the five fiduciary employees on the basis that they had breached their fiduciary duties. In their defence, the employees pleaded that they had been wrongfully dismissed.

The court considered two principal questions:

1. Had the employees been wrongfully dismissed?
2. If the employees had been wrongfully dismissed, did their fiduciary duties survive the wrongful dismissal?

The court concluded that *Zesta* had wrongfully dismissed the employees. The court found that the employees had set up a competing business and solicited *Zesta* customers, but that they had done so after they were terminated. That is, the evidence did not support the conclusion that the employees were involved in setting up a business while



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they were employed. Accordingly, Zesta did not have cause when it dismissed the employees.

The court concluded that, because the employer had breached the employment agreement and wrongfully dismissed the employees, the employees were relieved of any further fiduciary duties. In so concluding, the court adopted a line of authority that stands for the proposition that the employer is deemed to have repudiated the employment contract if the employer terminates the contract unlawfully - without reasonable notice or contrary to its specific terms. In turn, the employee is entitled to accept the repudiation and is relieved from all further obligations under the contract.

### **Post Zesta**

Note that the Ontario Superior Court of Justice arguably departed from the Zesta reasoning in its recent interlocutory decision in *Prendergast v. CHV Hydraulics, a Division of UAP Inc.*, [2002] O.J. No. 1837.

In *Prendergast*, the court granted the defendant's motion to amend its statement of defence in a wrongful dismissal action to add a counterclaim for damages for alleged breach of the non-competition and non-solicitation terms of

the employment contract.

The plaintiff argued, among other things, that the counterclaim was not tenable because the defendant, having repudiated the employment agreement, was not entitled to claim the benefit of the restrictive covenants of the agreement. The court rejected the plaintiff's argument, reasoning that, in the circumstances of this particular case, the commercial realities suggested an intention that the application of the covenants should survive the employment relationship. The defendant was therefore permitted to proceed with its counterclaim.

It should not be assumed, however, that the *Prendergast* decision in any way diminishes the significant implications of *Zesta*. The court in *Prendergast* was simply considering a motion to amend a statement of defence; the court made no final determination of liability.

In particular, the court made no determination regarding the employer's breach of the employment contract. At trial, if the court determines that the employer did breach the employment contract, the court may well find in its disposition of the counterclaim that the employer is not entitled to enforce

the restrictive covenants.

### **Implications of Zesta**

The decision in *Zesta* puts employers at considerable risk where a fiduciary employee is terminated without cause and without reasonable notice. Employers should carefully assess the potential harm that a terminated employee could bring to their business if the employee solicits customers or employees or seeks to usurp business opportunities. If there are significant risks, think twice before alleging cause for termination. Rather than allege cause, present a reasonable severance package and seek a settlement that includes an acknowledgement by the employee of his or her ongoing fiduciary obligations. Furthermore, *Zesta* underscores the important role of written employment contracts with clear and reasonable restrictive covenants. Written employment contracts should clearly outline the agreement of the parties to remain bound by the covenants regardless of how a termination occurs.

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