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The Supreme Court Weighs in on the Obligations of Departing Employees

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The Supreme Court of Canada has confirmed that there is an implied obligation of good faith owed by employees to their employers. In a decision released yesterday, *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.*, the Court found that a manager of investment advisors breached his duty of good faith when he orchestrated a mass defection with his subordinates to a competitor. The Court also found, however, that the investment advisors, who resigned without notice, were permitted to compete with their former employer immediately because they were neither fiduciaries nor were they subject to restrictive covenants.

THE FACTS GIVING RISE TO THE CASE

This case arose in 2000 in Cranbrook, British Columbia when virtually the entire office of RBC Dominion Securities ("RBC") resigned with no notice, and immediately began to work for Merrill Lynch. The branch manager led the defection of ten of the branch's investment advisors and seven members of its support staff. Before leaving, the employees removed and copied a variety of documents which contained significant amounts of client information, which they used to prepare solicitation letters to their former clients.

THE TRIAL JUDGEMENT

The Trial Judge awarded RBC approximately $2 million in damages – approximately $1.7 million for lost profits over a five-year period, and the remainder as punitive damages for the conversion of the client records. Although the employees did not have any provisions in their employment contracts restricting post-employment competition or solicitation, the Trial Judge found that the employees had violated an implied duty of good faith and an implied duty not to compete unfairly with their former employer.

THE JUDGEMENT OF THE BRITISH COLUMBIA COURT OF APPEAL

A majority of the British Columbia Court of Appeal allowed Merrill Lynch's appeal and held that RBC should only be compensated for the profits it lost during what should have been the period of reasonable notice of resignation – a period found by the Trial Judge to be 2.5 weeks per employee. This reduced the lost profit award from $1.7M to $40,000. The majority relied on two main lines of reasoning.

First, the majority held that RBC could not claim lost profits based on an alleged breach of confidentiality because it had not proven a link between the breach and its loss of clients. Although the majority did uphold the punitive damages award for the conversion of the client records, it also made broad statements favouring investment advisor mobility and the ability for the advisor to maintain and keep basic client contact information (names, phone numbers and email addresses). Such clients, the majority found, were "entitled to know immediately upon his advisor leaving one firm for another where that advisor has gone so that he or she can decide whether to change to the new firm or remain with the old."

Second, the majority held that RBC could not claim lost profits based on any conduct that occurred after the employees resigned from employment. It noted that none of the advisors were fiduciaries (who have special duties that continue to apply after employment ends), nor had any of them signed employment contracts with restrictive covenants. Therefore, they had no duty to refrain from soliciting their former clients and no (more general) duty not to compete unfairly.

THE JUDGEMENT OF THE SUPREME COURT OF CANADA

The first line of reasoning relied on by the majority of the Court of Appeal was not appealed to the Supreme Court.

The second line of reasoning was appealed, and the Supreme Court overturned it in part. With respect to the branch manager, the majority of the Court agreed with the Trial Judge that he was under an implied duty of good faith that required him to attempt to retain investment advisors for RBC. The majority also upheld the Trial Judge's finding that the branch manager was involved in organizing the mass departure of the investment advisors, and as such, he was in breach of this implied duty of good faith. The majority reinstated the entire five-year damage award for lost profits that had been made against the branch manager (about $1.5M of the original $1.7M).

With respect to the investment advisors, the Supreme Court found that, since they were not fiduciaries and were not subject to restrictive covenants, they were free to compete with their former employer as soon as they resigned from employment with RBC. This was so even though the investment advisors were obliged to provide notice of resignation, but did not do so. In coming to this conclusion, the Court rejected the notion of a general implied duty not to compete unfairly with a former employer. As a result, the damages for lost profits as against the investment advisers was limited to the 2.5 weeks notice of resignation period.

Justice Abella dissented from the majority on the issue of the damage award against the branch manager. In her opinion, the duty of good faith owed by an employee only goes so far as to prevent an employee from competing against his or her employer during employment, or making improper use of confidential information. The conclusion by the majority that the branch manager was in breach of his duty of good faith, Justice Abella found, effectively created a new category of "quasi-fiduciary" employees, which represents "a novel and potentially enormous liability on employees". She further concluded that "the duty of good faith has never before been applied to hold a non-fiduciary employee liable in damages for his or her failure to exercise the fullest possible diligence in pursuit of the employer's interests" and that the new duty would impose a "chilling effect" and "uncertainty" for management employees seeking to change employers.

SOME THOUGHTS ON THE JUDGEMENT

The majority's reasoning does seem to impose a higher duty on management employees to protect their employer's interests. This is good news for employers in industries where there is high competition for employees. The majority expressly rejected the notion of a new "quasi-fiduciary" category of employees. At the same time, however, its analysis of the duty of good faith does appear to expand the potential liability of managers who are disloyal to their employers. Does that mean that employees should be concerned that they will be facing liability for the slightest failure to "protect their employer's interests?" That is a question that will only be answered with time as new cases are litigated.

The judgement is also noteworthy for its rejection of a general implied duty not to compete unfairly with a former employer. In rejecting this concept, the Supreme Court has reaffirmed that for employees who are not fiduciaries, employers need to contract for reasonable restrictive covenants in order to protect legitimate business interests from post-employment solicitation and competition.

It is more difficult to anticipate the future impact of the B.C. Court of Appeal's broad statements favouring investment advisor mobility. Presumably, if these comments are adopted in future cases, they could apply to any provider of a highly-individualized service. As noted above, this aspect of the Court of Appeal judgement was not appealed, so the silence of the Supreme Court cannot be interpreted as an endorsement. However, the comments remain part of the legal fabric that surrounds the issue of departing employees, and it remains possible that courts may yet more widely embrace a recognition of a public interest in employee mobility in some sectors of the economy.

If you have any questions about the obligations of departing employees, please contact your regular Hicks Morley lawyer.

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