Fiduciary Obligations in Employment Relationships in Canada

Prepared for the Panel Discussion, “Wanna Keep a Secret, Eh?: Enforcing Restrictive Covenants in Canada and the United States

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**I. Introduction**

There is more than one way to keep a secret, and employers have certainly developed more than one way to keep their former employees from competing with them once the employee has left a particular organization or company. Restrictive covenants may seem like the most obvious instrument to accomplish these goals. However, even in the absence of restrictive covenants, employers may attempt to restrain the competitive actions of their current or former employees by claiming that the employment relationship has a fiduciary quality. If an employer succeeds in characterizing an employee as a fiduciary, that employee will owe the company a much more robust set of obligations – duties which, unlike those owed by regular employees, carry on even after their employment is terminated.
These fiduciary obligations will have many of the same effects as restrictive covenants, particularly in their restriction of a former fiduciary employee's competitive behaviour. Consequently employers will often attempt to characterize a current or former employee as a fiduciary in instances where the company has failed to negotiate a restrictive covenant either in the employment contract or at the time the individual's employment is terminated. Given the Canadian courts' unwillingness to amend unreasonable restrictive covenants, the argument of fiduciary obligation may also be advanced in the alternative when there is a chance that an existing restrictive covenant will be deemed unenforceable. The existence of any or a particular contractual relationship between the parties does not foreclose a finding that one party owed a fiduciary duty to the other. Thus, the specter of fiduciary duty can be raised by an employer whether or not restrictive covenants exist in the employment contract.

However, Canadian courts traditionally exercise considerable restraint when imposing fiduciary obligations on parties to an employment contract. An employment relationship is not presumptively or per se fiduciary. Therefore, a careful examination of the circumstances and characteristics of the parties' employment relationship is required in order to determine if it constitutes a relationship that gives rise to a fiduciary obligation. The question to be answered by this examination may be posed as follows: Is there evidence of a mutual understanding between the parties that the defendant has relinquished his self-interest and agreed to act solely on behalf of the plaintiff(s)? Characteristics which may lead a court to determine that an employment relationship is fiduciary in nature include instances where:

(i) the fiduciary has scope for the exercise of some discretion or power;

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1 See the paper submitted for this panel discussion by David J. Bannon of Norton Rose.
4 Ibid. at para 226.
(ii) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's (employer's) legal or practical interests; and

(iii) the beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power. 5

As will be discussed, there are no hard and fast rules as to who qualifies as a fiduciary and when. This paper will survey the approaches Canadian courts have taken when making this determination.

II. Employers Claiming the Fiduciary Status of an Employment Relationship

The courts' reluctance in finding fiduciary duties which arise out of employment contracts is clear in instances when an employer wants to sue an employee for breach of these obligations. While the law is not hesitant to recognize a duty of good faith and loyalty on the part of ordinary employees toward the employer, it has been hesitant to equate that duty to one that is essentially trustee in nature. The effect of such a finding would be a substantial restraint of trade. However, the determination of whether an individual is a "mere employee" who owes an implied contractual duty of loyalty or a fiduciary who owes a duty of utmost good faith is often a difficult question. The court described the difficulty of drawing this distinction in Barton Insurance Brokers Ltd. v. Irwin:

The theme running through this whole area of law is that, in appropriate circumstances, a former employee may be found to have breached an enforceable duty owed to a former employer and may be successfully sued for injunctive relief or for damages. [...] I suppose to avoid what might otherwise be a condition of almost involuntary servitude, it has long been held that an employee is free to compete for custom with a former employer. As usual in human affairs, the difficulty is in the details and it is often difficult to know where to draw the line. 6

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a. Different Duties: Mere Employees and Fiduciaries

Difficult as it may be, the distinction between mere employees and fiduciaries is very important. This is because the duty owed by a fiduciary to an employer is much more exacting and the remedies available to the employer are different, depending on the nature of the employee's breach.\(^7\) For example, an ordinary employee in Canada is entitled to prepare himself for alternate employment with competitors while still employed by the employer. In the absence of a restrictive covenant (and even with a restrictive covenant in many instances), a departing employee is free to compete with his employer and to make free use of the general knowledge and skill concerning the business he attained through his previous employment.\(^8\)

i. The Implied Term of Loyalty and Unfair Competition

Generally speaking, the law favours the freedom of former employees occupying less than senior management positions to pursue economic advantage through mobility in employment.\(^9\) A free market depends on the free mobility of human capital. Because of this, the implied term in all employment contracts that the employee will not, during the period of his employment, establish himself in competition with the employer does not automatically prohibit a worker from taking a second job outside his normal working hours, even if the second job is in the same industry and geographical area. Interpreting this implied term restrictively would curtail a worker's ability to secure a decent livelihood.

Thus, before just cause for summary dismissal is established or injunctive relief granted, the second job must give rise to a realistic conflict of interest or otherwise damage the first employer's business, for example, by creating a serious risk of divulging the first employer's confidential information or trade secrets. Furthermore, this duty imposed on ordinary employees does not prohibit

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an employee from preparing and planning to compete with his employer once the employment relationship has ended, and an employee who has terminated employment is generally not prevented from competing with his employer during the notice period.\textsuperscript{10}

\textbf{ii. Trade Secrets}

The only restrictions generally placed on ordinary or “mere” employees once their employment with a particular company has terminated, are a duty not to disclose the employer’s trade secrets to his new employer and a duty to not appropriate the employer’s property. As an implied term of all employment contracts, an employee who learns of or unearths an invention, discovery, or innovation becomes a trustee of the same for his employer and remains a trustee after he has left that employment. However, this does not prevent that employee from using the skills gained during his previous employment in his new employ.\textsuperscript{11} It will be a question of evidence to determine whether the former employee has used materials derived from a former employment or devised new materials.

Furthermore, a former employee’s obligation to maintain secrecy with regards to a trade secret remains only so long as the secret remains a secret. He may also use and exploit secret knowledge so long as it was discovered only by trial and error or experimentation after he had left his previous employment.\textsuperscript{12}

\textbf{iii. Fiduciary Duties}

A fiduciary employee is far more restricted. While employed, fiduciary employees cannot enter into engagements in which they have a personal interest that conflict with anything the employer does, or realistically may do, without first making full disclosure and obtaining the employer’s consent. He must adhere to

\textsuperscript{10} RBC Dominion Security Inc. v. Merrill Lynch Canada Inc., [1908] SCJ No 56, 298 DLR (4\textsuperscript{th}) (SCC) will be discussed at length latter on in this paper.


a strict ethic surviving his resignation from the corporation so as to prevent the usurping by him, or the divesting to another, of a business opportunity which the corporation is actively pursing.

iv. Drawing the Distinction
When the court can avoid drawing this distinction, it has. For example, in Stevens v. HSBC James Capel Canada Inc., the court noted that the relationship between the senior officer and his corporate employer was complex and multifaceted and that not all such employees' obligations were best dealt with as fiduciary obligations.¹³

I believe that the case sounds in contact and that contract law can accommodate and deal with the reliance, trust and dependency factors inherent in this employment relationship.¹⁴

Though fiduciary responsibilities are conventionally absent in a master-servant relationship, they have been found to exist with respect to both active and departing employees where the requisite deposing of “trust and confidence” exists. The law has developed several tests for imposing a fiduciary quality into an employment relationship. These tests are based primarily upon the employee’s degree of responsibility in the enterprise and will normally result in the attachment of fiduciary obligations to only top-level management such as directors and officers.

b. Officers, Directors and “Top Management”
Modern legislation imposes a duty on directors and officers to act honestly, in good faith and with a view to the best interest of the corporation¹⁵. While such legislation may appear to deem all directors and officers of corporations as fiduciaries, the Supreme Court of Canada, in Peoples Department Stores Inc.

¹⁴ Ibid.
¹⁵ See, for example, Section 122(1)(a) of the Canadian Business Corporations Act (RSC, 1985, c. C-44)
(Trustee of) v. Wise\textsuperscript{16} clarified the issue. It held that these statutory duties imposed on directors and officers were more properly described as duties ‘of loyalty’ than as fiduciary duties (although the Court did use the shorthand “statutory fiduciary duty” in its judgment).\textsuperscript{17} As such, an employer cannot merely rely on the language of these statutory duties when arguing that a director or officer is a fiduciary.

In its leading case on corporate director and officer liability, the Supreme Court of Canada articulated the first of several tests for determining when an employee constitutes a fiduciary – the “top management” test. A “mere employee”, as described by Laskin J. in Canadian Aero Service Ltd. v. O’Malley\textsuperscript{18}, will rarely be subject to the elevated duty owed by a fiduciary. However, Laskin J. cited judicial precedent to support the principle that senior management owes a fiduciary duty to the corporation.

The court paralleled the obligations owed by “top management” with the duty owed by an agent to his principal. It further described how those who qualify as senior or “top” management may not be restricted to the directors of a company. Addressing the two former employees whose status was in question in the case, Laskin J. stated that it did not matter whether the defendants were properly appointed as directors of the company or whether they did or did not act as directors.

What is not in doubt is that they acted respectively as president and executive vice-president of Canaero [the company] for about two years prior to their resignations. To paraphrase the findings of the trial Judge in this respect, they acted in those positions and their remuneration and responsibilities verified their status as senior officers of Canaero. They were “top management” and not mere employees whose duty to their employer, unless enlarged by contract, consisted only of respect for trade secrets and for confidentiality of customer lists. Theirs was a larger, more exacting duty which, unless modified by statute or by contract

\textsuperscript{16} [2004] 3 SCR 461.
\textsuperscript{17} See \textit{ibid.} at para 32.
\textsuperscript{18} [1974] SCR 592 [Canaero].
[...], was similar to that owed to a corporate employer by its directors. I adopt what is said on this point by Gower, *Principles of Modern Company Law*, 3rd ed. (1969), at p. 518 as follows:

"... there duties, except in so far as they depend on statutory provisions expressly limited to directors, are not so restricted but apply equally to any officials of the company who are authorized to act on its behalf, and in particular to those acting in a managerial capacity."

The distinction taken between agents and servants of an employer is apt here.

The judicial inquiry into whether or not an employee owes a fiduciary duty to the company commences with a focus on whether the individual whose activities are to be enjoined qualifies as "top management". Like in *Canearo*, this inquiry focuses on the individual's functions rather than his titular role(s). The question of whether a particular employee owes a fiduciary duty to the employer is fact-specific. As the Alberta Court of Appeal noted in *Anderson, Smyth & Kelly Customs Brokers Ltd. v. World Wide Customs Brokers Ltd.* 19, the law has moved away from the use of formal and recognized relationships as limiting the circumstances in which fiduciary obligations may be found. There is no comprehensive list of standard relationships giving rise to fiduciary obligations and, thus, there is no comprehensive list of employees within a corporation who are deemed to be fiduciaries. The substance of the relationship between the parties is critical, not the nomenclature used to describe it.

An alternative formulation of the "top management" test is that fiduciary status is limited to those employees who have "the power and the ability to direct and guide the affairs of the company".20 Some restricted cases have the interpretation of "top management" to very senior persons exercising a substantial amount of autonomous power. For example, in *Empire Stevedores*

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20 See *RW Hamilton Ltd. v. Aeroquip Corp* (1998) 65 OR (2d) 345 (Ont. HC) as well as *Pan Pacific Recycling*. 
(1973), Ltd. v. Sparringa, the court found that, although the defendant held the title of vice-president of the company, he had "very little executive authority." In Genesta Manufacturing Ltd. v. Babey, the court concluded that the employee who was the "number two man" in the company did not exercise the degree of control over corporate operations that engendered a duty of utmost loyalty to the corporation after his departure from employment. Similarly, although the sole employee of a US company in Canada, a branch manager was found to exercise insufficient control to owe a fiduciary duty in Valco Cincinnati v. Dibe.

c. "Key Personnel"
Despite the narrow application of the "top management" test, the net of employees caught by fiduciary obligations to the company has been considerably widened in some instances by the adoption of the "key personnel" test. Although function remains the salient factor in the court's assessment, the word "key" may be interchanged with "essential", and this description is available to all levels of employment, not just senior management.

The "key personnel" tests looks at the relative role which the employee plays in the enterprise as opposed to the control and authority that come with his position. This test presents a serious danger of over-application and should be advanced with caution. As the court stated in Westcan Bulk Transport Ltd. v. Stewart,

All companies should consider good employees to be key employees. However, in order to be key employee who owes fiduciary duties to the employer, that employee must be one in which the employer has vested a high degree of trust and confidence.

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21 (1978), 19 OR (2d) 610 (HC) [leave to appeal refused (1978) 19 OR (2d) 610n (HC)]
22 Ibid. at p. 612.
23 (1984), 29 BLR 36 (Ont HC).
24 (1987), 35 BLR 281 (Ont HC).
26 Ibid., at para 66.
The reach of the “key personnel” test is illustrated in Demarco Agencies Ltd. v. Merlo, on which the salesman in question was deemed to be a “key employee” because he was responsible for more than fifty per cent of all the sales for the company.

However, a test of fiduciary status based on sales percentage or incidental interaction with corporate clients is not generally appropriate. The Ontario Court of Appeal has more recently held that sheer volume of sale was is not sufficient to brand a sales representative as a fiduciary employee. The court noted that, the fact that the business decision to rely so heavily on [the employee] may have turned out to be a less than prudent one is not sufficient to brand [the employee] as a fiduciary when the other hallmarks of a fiduciary relationship, such as the power to make or influence management decisions or set corporate policy, are absent. To find otherwise would mean the every salesperson, regardless of his or her position or authority in the business, would have a fiduciary duty simply because of his or her success in sales.

The Alberta Court have also pushed back against the over application of the “key employee” test. Not surprisingly, Mackin J. found that a truck driver who assumed primary responsibility for servicing an important client for 15 years was not a key employee because he had no discretion, power, authority over other employees, ability to delegate responsibilities, or capacity to affect the company’s legal or practical interests. As an excellent, though ordinary, employee, the defendant was permitted to consider alternative employment and, in doing so, did not breach his common law duty of fidelity or good faith to the company.

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d. Other Factors Considered by Courts and the Present Confusion

Besides the "top management" and "key personnel" tests, some courts have also looked to factors such as the size of the business, the employer's vulnerability, and even length of employment when determining the fiduciary status of an employee. The present confusion created by the various tests for fiduciary status was, unfortunately, left un-elucidated by the most recent Supreme Court of Canada case on the topic; *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.* RBC's activities in this case fall squarely within the topic for this paper. Having neglected to negotiate a reasonable restrictive covenant, RBC wished to characterize a part-time branch manager as a fiduciary in order that his competitive behaviour be deemed compensable.

In this case, the Supreme Court found that the implied contractual duty of good faith owed by the branch manager included a duty to retain the bank's employees. The court noted that an employee is generally not prevented from competing with his employer during the notice period that a departing employee is required to work before leaving his employer, and that an employer's damages are typically confined to damages for failure to give reasonable notice in such circumstance. Still, it awarded global loss of profits against the part-time branch manager after he facilitated the recruitment of the bank's investment advisors to competitor Merrill Lynch.

Abella J., writing in dissent, articulates the way in which the majority decision further confound the law surrounding fiduciary duties in employment relationships. She frames the question for the court by asking "[...] at what point does the breakdown of an employment relationship cross the legal line from

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30 See, for example, *EJ Personnel Services Inc. v. Quality Personnel Inc* (1985) 6 CPR (2d) 173 (Ont HC) at pp. 176-177
32 See *Gordon Trailer Sales & Rentals Ltd. v. Lenten* (1989), 25 CPR (2d) 1 (Ont HC) and *Spiderpaw Canada Ltd. v. Lyons*, 2004 ABQB 921 (Alta QB) at para 39.
conduct that is disappointing to conduct that is compensable? The trial judge found that the branch manager was not a fiduciary employee but nonetheless imposed a fiduciary-like, elevated duty of good faith. The trial judge concluded that the branch manager’s implied duty of good faith included an enforceable obligation to protect RBC’s interest by actively attempting to retain investment advisors within RBC. In dissent at the Supreme Court of Canada level, Abella J., wrote that injecting such an enhanced content into the duty of good faith owed by a non-fiduciary employee has the effect of creating a new legal category of “quasi-fiduciary” employees - a subset the law has not yet and should not be recognized.

Expanding the scope of the duty of good faith in this manner represents a novel and potentially enormous liability on employees. This development, in my view, is not only unwelcome in its uncertainty and punitive in its impact, it also risks widening what this Court has long recognized to be the imbalance of power in employment relationships, by further entrenching the inherent vulnerability of employees. […]

An employee is not an indentured servant. […] 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 the pursuit of the employer’s interests.

e. Independent Contractors

It may be possible for an employee to raise the concept of “independent contractor” as a shield to defray the employment nexus essential to the loyalty owed by “top management” or “key personnel”. Prima facie, independent contractors are not compelled to act as fiduciaries. However, as in all circumstances, the court will look to the particular nature of the relationship before making a determination. After reviewing case law on this topic, the court in TSP-Intl Ltd. v. Mills noted that:

Fiduciary duties may apply to independent contractors […]. However, in a recent series of cases looking at the obligations of independent contractors, courts have

34 Ibid., at para 26.
35 Ibid., at paras 51-53.
been reluctant to impose theses significant duties upon the contracting parties involving independent contractors unless the facts are clear, and the precise requisite legal elements are met.\textsuperscript{37}

\textbf{1. Restrictive Covenants v. Fiduciary Restraints}

It may be possible for an employee to assert that the presence of a restrictive covenant in his employment contract undermines an employer's argument that he is a fiduciary.

The issue of restrictive covenants is a different issue than the common law prohibition against competition for a fiduciary. In \textit{McCorduck v. Diachem Industries Ltd.}\textsuperscript{38}, Locke J. held that the existence of a fiduciary duty was an equitable doctrine irrelevant to the interpretation of the contractual terms of a restrictive agreement. A contractual restraint through a restrictive covenant differs in treatment and in consequence from a prohibition created by equitable principles. The courts can enforce either or both in any given case.

However, counsel for employees may be able to use the existence of a restrictive covenant in an employment contract to undermine an employer's arguments for the imposition of fiduciary status on their client. It has been decided that parties may dictate, through contract, what type of relationship subsists, particularly at the onset of the relationship, and especially at the conclusion of the relationship. Thus, by reducing the post-employment prohibitions to writing, it will likely be found that the employer and employee are bound by the contractual items rather than by equitable principles.

\textsuperscript{37} \textit{Ibid.}, at para 54.
\textsuperscript{38} (1965), 33 ACWS (2d) 332 (BCSC).
III. Employees Claiming the Fiduciary Status of an Employment Relationship

Though infrequent, employees have occasionally claimed that their employment relationship is fiduciary in nature when suing their employer. However, in ordinary circumstances, courts will not readily find that an employer owes a fiduciary duty to the employee.

While courts will typically dismiss a claim by an employee for breach of fiduciary duty on behalf of the employer, it is clear that the courts will not refuse to consider the possibility of fiduciary obligations arising out of an employer-employee relationship. For example, in Oliver v. Severance,⁴⁹ the court refused to strike an employee’s claim and noted that,

Business relationships appear to be the most common spawning ground for claims of breach of fiduciary relationship. Employment relationship situations are newer to the claim and are still an uncommon source of claim; but they are not unknown to the law.⁴⁰

Thus far, the court has only been willing to find that an employer has breached a fiduciary obligation owed to an employee in situations where the employee is particularly vulnerable to the discretion of the employer. In Dopf v. Royal Bank of Canada⁴¹, the British Columbia Court of Appeal looked to the dynamics underlying the parties' relationship and noted that the nature of an otherwise contractual relationship may 'shift'. "When these shifts give rise to an exploited vulnerability, the relationship may become fiduciary in character."⁴² This vulnerability was described by La Forest J., writing for the majority of the Supreme Court in Hodgkinson, as a "power-dependency" relationship. This line of reasoning has been applied in cases such as Mustaji v. Tjin⁴³ wherein the

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⁴⁹ 142 LAC (4th) 194
⁴⁰ Ibid., at para 94.
⁴² Ibid., at paras 64-65.
court awarded substantial exemplary and punitive damages to a Foreign Domestic Worker for breach of fiduciary duty by her defendant employer.

**IV. Conclusions**

The distinction between ordinary and fiduciary employees is clearly one that can be difficult to draw. However, when the courts' approach to this distinction is looked at in combination with their disinclination to enforce restrictive covenants on former employees, a theme is clear. The court's approach to the obligations of former employees is pragmatic. It seeks to restrict employee's behaviour if it is necessary to protect the employer's legitimate business interest. Generally speaking, the law favours the freedom of former employees to pursue economic advantage since a free market relies on the mobility of its human capital. However, cases like *RBC Dominion Securities* illustrate the court's willingness to stretch the law in order to penalize and render compensable behaviour it perceives as particularly egregious.