

## Former corporate managers, fiduciary obligations, and the public policy in favor of competition

Bruce Welling

Volume 31, numéro 4, 1990

URI : <https://id.erudit.org/iderudit/043056ar>  
DOI : <https://doi.org/10.7202/043056ar>

[Aller au sommaire du numéro](#)

Éditeur(s)

Faculté de droit de l'Université Laval

ISSN

0007-974X (imprimé)  
1918-8218 (numérique)

[Découvrir la revue](#)

Citer cet article

Welling, B. (1990). Former corporate managers, fiduciary obligations, and the public policy in favor of competition. *Les Cahiers de droit*, 31(4), 1095–1124. <https://doi.org/10.7202/043056ar>

Résumé de l'article

En vertu de la common law, les dirigeants d'une corporation ont des devoirs fiduciaires envers celle-ci. Plus particulièrement depuis l'arrêt de la Cour suprême dans l'affaire *Canaero*, rendu en 1974, cette situation a compliqué l'analyse juridique des activités exercées par les anciens dirigeants d'une corporation qui sont en concurrence avec cette dernière. On a depuis longtemps permis à d'anciens employés d'une corporation de livrer concurrence à leur ancien employeur, à la condition qu'ils n'utilisent pas les biens de la corporation, ni n'enfreignent des obligations contractuelles de non-concurrence. Quant aux tentatives de limiter la concurrence ultérieure, l'application du concept d'ordre public, favorable à la libre concurrence, a conduit depuis longtemps à une interprétation restrictive des dispositions contractuelles de cette nature.

Selon les principes de l'*Equity*, il est aussi possible de poursuivre les anciens dirigeants de corporations en vue d'obtenir une reddition de comptes ou des dommages-intérêts. La *corporate opportunity doctrine* n'a fait qu'embrouiller l'analyse juridique de ces recours ; il en a été de même de l'utilisation de cette conception erronée voulant qu'une obligation de nature fiduciaire existe après la démission de la fonction qui lui a donné naissance. Cette étude critique des interprétations jurisprudentielles ; elle vise à démontrer que les recours fondés sur l'*Equity* sont également assujettis à l'application du concept d'ordre public, qui favorise la concurrence, mais que, par ailleurs, l'évaluation du préjudice subi est plus difficile qu'en matière contractuelle.

# Former corporate managers, fiduciary obligations, and the public policy in favor of competition

---

Bruce WELLING\*

*In common law systems corporate managers owe fiduciary obligations to their corporations. This has complicated the legal analysis of competitive business activities by former corporate managers, particularly since the 1974 Supreme Court of Canada decision in Canaero. Other former corporate employees have long been allowed to compete with their ex-employers, so long as they do not use their ex-employers' property or breach terms of any contracts restraining their business activities. Attempts to contract to restrain future competitive business activities have long been restricted by the public policy in favor of competition.*

*Former corporate managers can also be sued in Equity: the remedy is for an accounting of profits or for equitable damages. The judicial analysis of these equitable actions has been mystified by the "corporate opportunity doctrine" and the mistaken notion that a fiduciary obligation can survive resignation from the fiduciary position that created the obligation. A review of the basics exposes the errors and shows that equitable accounting and equitable damages remedies are also subject to the public policy in favor of competition, but that the calculation is more complicated than in contracts.*

---

*En vertu de la common law, les dirigeants d'une corporation ont des devoirs fiduciaires envers celle-ci. Plus particulièrement depuis l'arrêt de*

---

\* Associate Professor, Faculty of Law, University of Western Ontario. The research assistance of Susan de Valencia and Paul Lesarge is gratefully acknowledged.

la Cour suprême dans l'affaire *Canaero*, rendu en 1974, cette situation a compliqué l'analyse juridique des activités exercées par les anciens dirigeants d'une corporation qui sont en concurrence avec cette dernière. On a depuis longtemps permis à d'anciens employés d'une corporation de livrer concurrence à leur ancien employeur, à la condition qu'ils n'utilisent pas les biens de la corporation, ni n'enfreignent des obligations contractuelles de non-concurrence. Quant aux tentatives de limiter la concurrence ultérieure, l'application du concept d'ordre public, favorable à la libre concurrence, a conduit depuis longtemps à une interprétation restrictive des dispositions contractuelles de cette nature.

Selon les principes de l'Equity, il est aussi possible de poursuivre les anciens dirigeants de corporations en vue d'obtenir une reddition de comptes ou des dommages-intérêts. La corporate opportunity doctrine n'a fait qu'embrouiller l'analyse juridique de ces recours; il en a été de même de l'utilisation de cette conception erronée voulant qu'une obligation de nature fiduciaire existe après la démission de la fonction qui lui a donné naissance. Cette étude critique des interprétations jurisprudentielles; elle vise à démontrer que les recours fondés sur l'Equity sont également assujettis à l'application du concept d'ordre public, qui favorise la concurrence, mais que, par ailleurs, l'évaluation du préjudice subi est plus difficile qu'en matière contractuelle.

---

<b>1. The problem</b> .....	1097
1.1. Runaway fiduciary obligations .....	1097
1.2. Genesis and exodus .....	1097
1.3. Leviticus, and unruly horses .....	1098
<b>2. The public policy in favor of competition</b> .....	1099
<b>3. Former managers and contractual obligations</b> .....	1100
3.1. The rule .....	1100
3.1.1. Theory .....	1100
3.1.2. Practice .....	1101
3.2. The reason for the rule .....	1102
3.3. Applying the rule .....	1102
3.4. Summary: contract and public policy .....	1105
<b>4. Former managers and fiduciary obligations</b> .....	1105
4.1. Fiduciary accountability: the rule .....	1108
4.1.1. Theory .....	1109
4.1.2. Practice .....	1110
4.2. The errors in the practice .....	1118
4.3. Applying the rule .....	1122
4.4. Summary: fiduciary obligation and public policy .....	1124

---

## 1. The problem

### 1.1. Runaway fiduciary obligations

The time has come to rein in runaway fiduciary duties.

The area most wanting sober review is the accountability of former corporate managers who compete with their ex-employers. Most of them aren't accountable on the basis of fiduciary theory at all. Some of them may be, but the courts have so far ignored a rather obvious limit on the extent of their potential liability.

### 1.2. Genesis and exodus

Things were manageable in the days when fiduciary duties began to be required of trustees. Trustees were easily identifiable—they held property in land (or in things) according to the rules of common law, but had undertaken to hold the property for the benefit of someone else, often a child or a woman subject to impediment of marriage. Their legal obligations were easily understood. In the common law courts, they had none: a trustee was at liberty to behave like any other holder of property. Equity, however, had different property rules and Equity judges expected holders of common law property to heed the dictates of religious mores. In the Chancellor's court a trustee could be assisted in doing so by hints of extra-terrestrial intervention and, for the more recalcitrant, thumbscrews. Things were a lot simpler in the days when the Chancellor was a priest, the populace at least pretended to subscribe to shared religious ideals, and priests could plausibly damn the unconcionable to hellfire or rack them to salvation.

Things were still comprehensible when the traditional licensed pillars of the community—doctors, lawyers, bankers, priests, etc.—were included as fiduciaries. This required them to dispense advice with due regard for the fact they were not dealing with customers of equal bargaining power, but with trusting souls who were dazzled by their credentials and hung on their every word. Corporate directors too were obvious fiduciaries—not because their corporations were in awe of them, but because of the raw power they wielded over every aspect of corporate life.

Things began to get out of control when Bora Laskin opined that fiduciary obligations owed by “senior” corporate officers continued to exist after their resignations<sup>1</sup>. Things stopped making sense temporarily

---

1. *Canadian Aero Services Ltd. v. O'Malley*, [1974] S.C.R. 592, 40 D.L.R. (3d) 371 (S.C.C.). I shall have more to say on this point later.

when Lac Minerals Ltd. were determined by the Ontario courts to have owed International Corona Resources Ltd. a fiduciary obligation because they were “intending partners” (*intending ??*) and because of a so-called “practice” in the mining industry<sup>2</sup>. The Supreme Court of Canada tried to put a stop to the fiduciary bandwagon at the final appeal<sup>3</sup>, but time will tell whether they succeeded.

### 1.3. Leviticus, and unruly horses

The sprawl of accountability for breach of fiduciary obligation is contrary to public policy.

“Public policy” is, in law, a minimal set of basic rules, not a dictatorial state of mind. I am no advocate of judicial fiat couched in the rhetoric of statesmanship. But there are some simple canons judges can’t ignore. There are underlying principles so basic to our system of government that they must be invoked whenever the application of a lesser rule would offend them. There is danger in over-application of these principles, yet there is sometimes more to be lost when they are forgotten. The problem lies not in whether judges are to apply them, but how.

Lors Denning said something uncommonly wise (and characteristically picturesque) about public policy in 1971<sup>4</sup>.

I know that over 300 years ago Hobart, CJ said that “Public policy is an unruly horse”. It has often been repeated since. So unruly is the horse, it is said... that no judge should ever mount it lest it run away with him. I disagree. With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles. It can leap the fences put up by fictions and come down on the side of justice. ... It can hold a rule to be invalid even though it is contained in a contract.

It is time to prefer the unruly horse of public policy to the stampede of fiduciary obligations. The particular horse I have in mind is the public policy in favor of competition.

- 
2. *International Corona Resources Ltd. v. Lac Minerals Ltd.*, (1986) 32 B.L.R. 15 (Ont. H.C.) at p. 65 ff., aff’d (1987) 62 O.R. (2d) 1, 44 D.L.R. (4th) 592 (Ont. C.A.). Would this mean that because other people in a particular business usually do things in a certain way, you can’t act like a normal competitor? What next? Perhaps a people’s shop steward, preferably one with a Scottish accent, could be stationed at every used car lot to proclaim at regular intervals “yer not bargainin’ in gud faith”.
  3. *International Corona Resources Ltd. v. Lac Minerals Ltd.*, (1989) 44 B.L.R. 1 (S.C.C.). I shall deal with the case in more detail later.
  4. *Enderley Town Football Club v. Football Association* [1971] 1 Ch. 591 (Eng.), citing Burrough, J. in *Richardson v. Mellish*, (1824) 2 Bing. 229, 252, 130 E.R. 294 (Eng.) who warned: “It [public policy] may lead you from the sound law. It is never argued at all but when other points fail”.

## 2. The public policy in favor of competition

The common law provinces inherited a system of law that favors competition in commercial matters. Common law courts have traditionally referred to “the public policy against restraint of trade”. A classic, old-fashioned recitation of the policy can be found in *The Case of the Tailors & Co. of Ipswich*<sup>5</sup>.

[A]t the common law, no man could be prohibited from working in any lawful trade, for the law abhors idleness, the mother of all evil... and especially in young men, who ought in their youth, (which is their seed time) to learn lawful sciences and trades, which are profitable to the commonwealth, and whereof they might reap the fruit in their old age, for idle in youth, poor in age; and therefore the common law abhors all monopolies, which may prohibit any from working in any lawful trade... so if a husbandman is bound that he shall not sow his land, the bond is against the common law... [The rules of the tailors guild] are against the liberty and freedom of the subject, and are a means of extortion in drawing money from them, either by delay, or some other subtle device, or of oppression of young tradesmen, by the old and rich of the same trade, not permitting them the work in their trade freely; and all this is against the common law and the commonwealth.

Note the orientation. The bias is pro-individual, anti-organization. To the extent that collective interests are to be protected, they are the interests of the entire collective (“the commonwealth”). Don’t be tricked by the limited vision of members of a sub-collective who monopolize a trade in order (so *they* say) to benefit us all.

The “interests of the collective” really means nothing more than the collective interests of individuals within the society. We can’t calculate that by adding up the individual interests of all the individuals: they conflict. Consequently, our legal system imposes compromises. Moreover, time and money incline us to characterize interests by type, rather than trying to estimate each minor variant in taste or prejudice. We seek to characterize the self-interest of a rational hypothetical person of each type. What we require of judges — who decide whose interests are to be compromised, and when — is a careful consideration of all the types of interests involved.

When former corporate managers compete with their ex-employers, four types of interests warrant consideration. A rational ex-employer would hope to limit direct competition. A former manager would seek to capitalize on his experience and marketable talent. Potential employers would like to rent the experience and talent. Clients, past and future, want what the manager can manage to produce at the lowest possible price.

---

5. *In the Case of the Tailors & Co of Ipswich*, (1614) 11 Co.Rep.53a, 77 E.R. 1218 (Eng.).

The case of a former manager who joins a competitor invokes all four types of interests. The case of a former manager who seeks to compete on his own may appear superficially different, as potential employers see themselves as both competitors and future ex-employers of managers who might do the same. But the legal analysis can't be different. Otherwise, the public policy in favor of competition would become biased against new competitors in the marketplace.

Rules inhibiting the competitive activities of former managers arise from two sources. One is contract. The other is fiduciary obligation.

### 3. Former managers and contractual obligations

#### 3.1. The rule

##### 3.1.1. Theory

A contract is accurately described as a promise enforceable by legal action. By contrast, the word agreement describes any manifestation by two (or more) persons of mutual assent to a proposition. An agreement may or may not create legal obligations. A contract, by definition, does.

Parties negotiating a contract often reach agreement on many details. Not all agreed terms become contractual terms. A trite example would be an agreement to have lunch during the negotiations: either party remains at liberty to make other lunch arrangements as neither would be able to prove that lunch was what they were attempting to contract about<sup>6</sup>. An equally simple issue arises when parties agree to commit a crime. No one can stop two people from agreeing to murder someone, but the legal system will not order anyone to carry out the agreement or to pay damages for violating it. The rationality of this conclusion is variously explained<sup>7</sup>, but it is most easily stated in plain speech—a promise to commit a crime may well be a term of an agreement, but it can not be a term of a contract.

6. "When it is said that contract is founded upon promises and upon agreement about promises, this must be understood as subject to the qualification that the promises, and the agreement, are designed and intended to have legal effect": G.H.L. Fridman, *The Law of Contract*, 2d. ed., Toronto, Carswell, 1986, p. 6 and "When is a statement a term?" at p. 429. Similarly, see S.M. Waddams, *The Law of Contracts*, 2d. ed., Toronto, Canada Law Book, 1984, p. 115 "Social Engagements and Jests".

7. See, for example, G.H.L. Fridman, *supra*, note 6, p. 353: "Thus, a *contract* to undertake broadcasting, when it was illegal to do so by reason of a failure to obtain the necessary licence, was held *void*...". Compare S.M. Waddams, *supra*, note 6, p. 421: "Courts have often held that such *agreements* are *void* and unenforceable". [emphasis added]

To the extent that there is a public policy in favor of competition, competition cannot be limited by contract. The reason is the same as in the cases of casual lunch arrangements and criminal conspiracies. Public policy is, by nature, legally enforceable. A contract is, by definition, legally enforceable. It follows that a promise that is contrary to public policy and therefore not legally enforceable could not possibly be a term of a contract.

It is unlikely that the public policy in favor of competition is absolute. Some agreements that restrict competition are enforceable. My contract to show up for class at Western as scheduled next week is undoubtedly one of them. The fact that I might prefer to play poker instead is no defence. It is true that competition is lessened: the more skilful players at the poker table are deprived of the opportunity to fleece me of my money; my students are deprived of the opportunity to bargain for real pearls of wisdom<sup>8</sup>. Yet the degree to which competition is lessened is insufficient to warrant invocation of the public policy in favor of competition.

By contrast, an attempt to contract to restrict competition to an excessive degree will fail because it is illegal, and therefore impossible. Any such term may well be part of an agreement between an employer and a manager, but it can not be a term of their *contract*.

### 3.1.2. Practice

The courts have consistently applied the theory.

A non-competition clause in an agreement between a corporate manager and his corporation (or between any employer and employee) can not be a term of their contract if it is excessively wide in geographical application or too long in duration. The Supreme Court of Canada put it thus<sup>9</sup>:

the principles to be applied in considering restrictive covenants of employment are well-established. ... A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest.

The terminology used by judges is sometimes arcane. They seem to prefer mysterious words like “covenants” and self-contradictory phrases like “void contracts”. But the underlying message is clear. Corporate

---

8. One of the gentlemen I used to work with described professing law as “the art of casting false pearls before real swine”. I have often wondered which side of his cast was caricature, and which satire.

9. *Elsley v. J.G. Collins Ins. Agencies*, [1978] 2 S.C.R. 916, p. 923. For a recent case in which an agreed term was rejected because of its geographical scope, see *Reed Stenhouse Ltd. v. Foster*, (1989) 69 Alta. L.R. (2d) 80 (Alta. Q.B.).



managers can be employed, but they can't be enslaved ; their services can be rented, but they can't be kept out of the marketplace forever.

### 3.2. The reason for the rule

It is perfectly clear that the reason for the rule is the public policy in favor of competition.

Agreements to refrain from future competitive activity have long been part of the hiring process for both managerial and non-managerial personnel. Attempts to preclude the future use of an employee's labor, technical, or managerial skills have routinely been struck down by the courts. The public policy in favor of competition (or, as judges often refer to it, the public policy against restraint of trade) has routinely been given as the reason. An oft-quoted 1916 English case summarizes the judicial attitude<sup>10</sup>.

Public policy requires that every man shall be at liberty to work for himself and shall not be at liberty to deprive himself or the State of his labour, skill, or talent, by any contract that he enter into. ...[A] contract is an embargo upon the energies and activities and labour of a citizen ; and the public interest coincides with his own in preventing him, on the one hand, from being deprived of the opportunity of earning his living, and in preventing the public, on the other, from being deprived of the work and service of a useful member of society.

Both the rule and the reason for the rule are uncontroversial<sup>11</sup>.

### 3.3. Applying the rule

Like most legal rules, this one is simpler to state than apply. However, some pretty clear principles of interpretation have been established. I propose to review them briefly. This will lay the foundation for my main point, which is that the same rule and the same principles of interpretation apply to the fiduciary obligation owed by departing corporate managers.

The rule clearly covers the future use of physical and mental skills. As noted in *Morris, Ltd. v. Saxelby*<sup>12</sup>, no one can be contractually obliged "to deprive himself or the State of his labour, skill, or talent" except within the narrow range of limitations allowed.

10. *Morris Ltd. v. Saxelby*, [1916] 1 A.C. 688 (Eng. H.L.) per Lord Atkinson at p. 701 and p. 708.

11. See generally R.A. Brait, "The Use of Restrictive Covenants in the Employment Contract", (1981) 6 *Queen's L.J.* 414.

12. *Morris Ltd. v. Saxelby*, *supra*, note 10. Any textbook on the law of contracts will confirm this uncontroversial point.

However, the rule has no application to property. Contract is one of the most common transactions by which property is acquired. Property, once acquired, may be retained and protected from intruders without regard to time or geographical scope<sup>13</sup>. Property in things provides the simplest illustration. A person who sells ownership of a dog cannot invoke public policy and reclaim ownership after a “reasonable” time, or retake possession if the dog is found to have strayed beyond a “reasonable” distance from its new home. The situation is the same, and equally obvious, in the case of patents. An inventor who develops a new process and acquires a patent has secured state protection from replication of the process for the period of years set by statute. The patent can be sold to a “licence”, who will get the same state protection from third parties. The original holder of the patent may prefer inventing to manufacturing. It is not contrary to the public policy in favor of competition for the original holder of the patent to contract away his own rights to replicate the process. This very point was noted in *Morris, Ltd. v. Saxelby*<sup>14</sup>.

On the other hand, public policy requires that when a man has by skill or by any other means obtained something he wants to sell, he should be at liberty to sell it in the most advantageous way in the market; and in order to enable him to sell it advantageously in the market it is necessary that he should be able to preclude himself from entering into competition with the purchaser.

A transfer of property, unlike a promise to retire from business, can be forever. The principle is the same whether property in a thing (like a dog, or a car) is involved or *property other than property in things* is being protected. The latter type of property—including patents, trademarks, copyright and all the other forms of property recognized by law but not directly concerned with possession of a physical object—is commonly labelled *choses in action* by otherwise English speaking legal analysts. Both types of property can be protected, despite the public policy in favor of competition: the only distinction is that it is harder to recognize a proprietary claim in the latter category because of the foggy way common lawyers talk.

---

13. Except where the property itself expires over time—as in the case of an option to purchase corporate shares at a set price before a specified deadline—or where the property holder seeks to enforce claims in another state that may have different property rules.

14. *Morris Ltd. v. Saxelby*, *supra*, note 10, per Lord Atkinson, p. 701. By contrast, “[i]n the case of restraints upon the opportunity to a workman to earn his livelihood, a different set of considerations comes into play. No actual thing is sold or handed over by a present to a future possessor.” [p. 708].

A 1920 English case summarized the distinction between attempted contractual restraints on trade and property claims as follows<sup>15</sup>.

The employer's goodwill is always necessarily subject to the competition of all persons, including the employee, who choose to engage in a similar trade. The employer in such a case is not endeavouring to protect what he has, but to gain a special advantage he could not otherwise secure. Accordingly covenants against competition by a former servant are as such not upheld; and the permissible extent of any covenant imposed upon a servant must be tested in every case with reference to the character of the work done for the employer by the servant while in his service and by the consideration whether in that view the covenant taken from him goes further than is reasonably necessary for the protection of the *proprietary rights* of the covenantee. [emphasis added]

Thus, an ex-employer can protect property, however acquired, but former employees who compete without interfering with the ex-employer's property are protected by the public policy in favor of competition.

The technique by which courts impose the public policy limitation can be stated bluntly. Without telling us exactly how many months of enforced idleness would be the maximum allowed by the public policy in favor of competition, the judge says whether the agreed term is under or over the maximum. Without specifying the maximum geographical area that could possibly be covered by a contractual term without violating the public policy in favor of competition, the judge says whether the agreed term is under or over the maximum<sup>16</sup>. Agreed terms under the maximum are enforced; agreed terms over the maximum are typically said to be "of no force and effect".

We already know why. Agreements aren't legally enforceable unless they are contracts. The issue is whether the parties' agreed terms limiting competition are contractual terms. They are so long as they comply with the public policy in favor of competition. They can't be terms of a contract, and they create no contractual obligation, if they don't comply.

---

15. *Attwood v. Lamont*, [1920] 3 K.B.D. 571 (Eng. C.A.), p. 590 per Younger L.J.

16. This is the standard process by which common law courts have always proceeded when dealing with non-statutory rules. Once any common law rule is stated, a spectrum of possibilities can be visualized. Consider the tort of battery, intentional physical interference with the person. Deliberately striking a defenceless bystander with an ax constitutes battery. At the other end of the spectrum, accidentally brushing against a fellow passenger on a crowded bus is not. Somewhere in the middle of the spectrum is a gray area; somewhere in the gray area is the precise line dividing the spectrum into tort and non-tort. Judges occasionally narrow the gray area, but only by telling us which side of the still hidden dividing line the facts of the case fall on.

The effect is simple. No compromise is possible in the judge's ruling on an agreed restraint of trade clause. If the parties agreed to 18 months of non-competition within the province of Prince Edward Island and that is found to be permitted by public policy, then a breach of the term is compensable by up to 18 months worth of damages. Whether they could have contracted for 24 months of non-competition is a red herring: they didn't. On the other hand, if the parties agreed to 36 months of non-competition within the province of Newfoundland and that is found *not* to be permitted by public policy, then there is no contractual term to enforce. Whether they could have contracted for 24 months of non-competition is a red herring: they didn't contract *any* non-competition term, so no breach of contract has occurred.

### **3.4. Summary: contract and public policy**

The public policy in favor of competition is well established. So is its application to employer/employee agreements restraining future competition. In fact, the association between the two is so familiar that the public policy is sometimes mistaken for a rule of contract: it is more basic than that.

I emphasize the basics because they will resurface during my comments on the fiduciary obligations of former corporate managers. My thesis is that lawyers defending equitable claims often ignore the underlying principles. Consequently, they make some big mistakes. Four key points arise from the analysis so far.

- (i) Private agreements would not be enforceable at all but for the general law of contracts which was judicially developed in the common law.
- (ii) Agreements to refrain from using one's physical and mental skills in future competition with one's former employer are not legally enforceable except within narrow limitations of duration and geographical area.
- (iii) The reason is not peculiar to the common law of contracts; rather, the reason is the overriding effect of the public policy in favor of competition.
- (iv) Both the rule and the reason for the rule are uncontroversial and a settled part of our law.

## **4. Former managers and fiduciary obligations**

Corporate managers—directors and officers—owe fiduciary obligations to their corporations. The concept of fiduciary obligation was

developed over the centuries by courts of Equity<sup>17</sup>. It was extended to corporate directors because they occupied positions which gave them legal powers which were intended to be used for the sole benefit of someone else—the corporation<sup>18</sup>. It was later extended to corporate officers, first by judicial extrapolation<sup>19</sup> and later by statute<sup>20</sup>.

It is often said that former corporate managers continue to owe fiduciary obligations to their corporations after they resign<sup>21</sup>. This is difficult to understand. Once the position which gave a former corporate manager *legal* powers over the corporate destiny no longer exists, doesn't the obligation imposed because of that position of legal power cease as well? What the courts are trying to explain when they say the fiduciary relationship continues is how a former corporate manager remains *accountable on the basis of fiduciary obligation* for certain competitive activities after resigning. That can be understood by examining the reasons for fiduciary accountability.

It is easy for a fiduciary to make a profit. Outsiders wanting to do business with a corporation must deal through corporate managers who have the legal power to make corporate decisions; those wanting to deal

17. The judicial attitude to someone found to occupy a fiduciary position was admirably summed up by Cardozo, C.J. in *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. C.A., 1928).

Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. ... Not honesty alone, but the punctilio of an honour the most sensitive, is then the standard of behaviour. As to this, there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

18. Directors were recognized as fiduciaries for their corporations well before the 20th century began. The rule was summed up in *Selangor United Rubber Estates Ltd. v. Craddock*, [1968] 2 All E.R. 1073 (Eng.): "Directors are clearly not trustees: ... they have business to conduct and business functions to perform in a business manner. [However] their powers, duties and functions qua directors are fiduciary for and on behalf of the company."

19. "Senior officers" of corporations were held to owe fiduciary obligations to their corporations in *Canadian Aero Service Ltd. v. O'Malley*, *supra*, note 1.

20. See eg. the *Canada Business Corporations Act*, R.S.C. 1985 c. C-44 s. 122 (1)(a): "Every director and officer of a corporation in exercising his powers and discharging his duties shall (a) act honestly and in good faith with a view to the best interests of the corporation...". Similar sections are found in most provincial corporate statutes and are generally accepted in the common law provinces as a statutory imposition of fiduciary obligation.

21. See, eg. *Edgar T. Alberts Ltd. v. Mountjoy*, (1977) 16 O.R. (2d) 682, p. 691 per Estey, C.J.: "the ex-employee defendants owed a duty to their former employer which transcended the severance of the employee—employer relationship".

with a wealthy child must negotiate with a trustee appointed to hold property on the child's behalf. It is up to the fiduciary to determine whether it is in the corporation's or the child's interests to accept the outsider's offer. Sometimes the fiduciary decides that it is not and decides to reject the offer. In such a situation, it would be easy to persuade the outsider that while the offer could not be taken up by the corporation, or on behalf of the child, the fiduciary was willing to accept it on his own behalf.

A fiduciary who does so, and profits as a result, is accountable<sup>22</sup>. Note that such a deal would not necessarily be a violation of the fiduciary's equitable obligations: the corporation might, for various reasons, be unable to exploit the business opportunity<sup>23</sup>; the terms of the trust might not permit the type of investment proposed<sup>24</sup>. Nevertheless, accountability is imposed. Lord Chancellor Eldon explained why in 1803<sup>25</sup>.

The doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principle than upon the circumstances of any individual case. It rests upon this: that the purchase is not permitted in any case however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases.

In short, accountability for profits is imposed on a particular fiduciary *pour encourager les autres*.

The underlying reason is a common one. Any legal system would break down but for the fact that most people comply with most laws

22. The rule dates at least as far back as *Keech v. Sandford*, (1726) Sel. Cas. Ch. 61 (Eng.), in which the ruling was even more severe. A lease, held by a trustee for the benefit of a child, expired. The trustee sought a renewal, but was refused, so he took a lease for his own benefit. He was ordered to assign the lease to the benefit of the child. Lord King, L.C. noted (p. 62):

This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly pursued and not in the least relaxed.

He also pointed out that if a trustee who was refused renewal of a lease might have the benefit for himself, few renewals would be made in trust!

23. That was what happened in two well-known cases, *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All E.R. 378 (Eng. H.L.), in which the corporation lacked the financing required, and *Industrial Development Consultants Ltd. (I.D.C.) v. Cooley*, [1972] 2 All E.R. 162 (Eng.), in which the outsider thought the corporation incapable of carrying out the project. The fiduciaries made personal profits, and were held accountable for their profits, in both cases.

24. This occurred in *Boardman v. Phipps*, [1967] 2 A.C. 46, [1966] 3 All E.R. 721 (Eng. H.L.). The trustee and another investor profited without prejudicing the beneficiaries under the trust in any way, yet were held accountable for their profits.

25. *Ex parte James*, (1803) 8 Ves. 337, 32 E.R. 385 (Eng.).

voluntarily. Human nature inclines voluntary compliance to be directly proportional to risk, inversely proportional to potential reward. The high degree of control exercised by a fiduciary minimizes risk, but greatly increases temptation. Equity — having abandoned therapeutic torture and convalescence in purgatory — helps resist the temptation by reducing the chance of reward<sup>26</sup>.

#### 4.1. Fiduciary accountability : the rule

The accountability rule started out on a simple basis. A fiduciary's duty was to serve the interests of someone else. If a situation arose in which duty and self-interest might conflict, the duty might be compromised. Any fiduciary who made a profit in such a situation was accountable for the profit to the person to whom the fiduciary duty was owed<sup>27</sup>. The profit, if sued for, would be taken away.

The rule has undergone some subtle changes during the 20th century. First, it is no longer true that the mere possibility of conflict of duty and interest will trigger the accounting remedy: if it is proved that no real conflict was involved, the fiduciary can keep the profit<sup>28</sup>. Second, the rhetoric has shifted: plaintiffs now routinely assert that the fiduciary absconded with a "corporate opportunity"<sup>29</sup>.

26. It does not appear to me that this rule is... founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule.

*Bray v. Ford*, [1896] A.C. 44 at p. 51-52 (Eng.H.L.) per Lord Herschell.

27. In *Aberdeen Railway Co. v. Blaikie Bros.*, (1854) 1 Macq. 461 (Scot.H.L.) it was said that "no one having such duties to discharge shall be allowed to enter into such engagements in which he has or can have a personal interest conflicting or which may conflict with the interests of those whom he is bound to protect". Inconsequentialist rules like this are of little use, except to describe situations that may give rise to some consequences. *Keech v. Sandford*, *supra*, note 22, was an early example of the consequences.

28. This is probably the rationalization for *Peso Silver Mines Ltd. v. Cropper*, [1966] S.C.R. 673, 58 D.L.R. (2d) 1 (S.C.C.), in which it was "impossible to say that the respondent obtained the interests he holds... by reason of the fact that he was a director of the appellant and in the course of the execution of that office". It was also the reason for denying accountability in *Holder v. Holder*, [1968] Ch. 353 (Eng. C.A.). It remains, however, difficult for a fiduciary to prove that there really was no conflict: see *Industrial Development Consultants Ltd. (I.D.C.) v. Cooley*, *supra*, note 23.

29. The "corporate opportunity doctrine" has been all the rage since the 1974 Supreme Court of Canada decision in *Canadian Aero Services Ltd. v. O'Malley*, *supra*, note 1. I shall have more to say about it later.

Former corporate managers are now held accountable for profit when either :

- (i) a conflict between self-interest and fiduciary duty led to the situation in which the profit was made ; or
- (ii) the opportunity to make the profit can be attributed to the fiduciary position formerly occupied.

Given those rules<sup>30</sup>, what about the public policy in favor of competition ? How is the public policy applied when former corporate managers are held accountable ?

#### **4.1.1. Theory**

Public policy sets an upper limit on the amount of profit for which any former corporate manager can be held accountable to an ex-employer. No ex-employer is entitled to profits earned outside a geographical area or after a period of time that is “reasonable in the circumstances”.

In calculating the upper limit in each case, four types of interests warrant consideration. These are precisely the same for types of interests identified earlier : (i) ex-employers (who hope to limit direct competition) ; (ii) former managers (who seek to capitalize on their experience and marketable talent) ; (iii) potential employers (who would like to rent the experience and talent), and (iv) past and future clients (who want what managers can manage to produce at the lowest possible price).

A proper equitable analysis must take account of all four types. The reason is the same as in the case of contracts. A corporate manager would owe no equitable or contractual obligations to the corporation at all but for the agreement by which he became a manager. No agreement can create obligations that are exempt from the overriding effect of the public policy in favor of competition. The public policy applies to terms expressed in the agreement, terms implied by the agreement, and claims derived from equitable principles invoked as a result of the agreement.

---

30. A detailed analysis of the development of these two rules can be found in B. Welling, *Corporate Law in Canada: the Governing Principles*, Toronto, Butterworths, 1984, p. 378-407. Not everyone agrees that these are, in fact, the rules. However, my purpose here is to show how the public policy in favor of competition applies to the accounting remedy : having *some* formulation of the accountability rules makes it easier to do that. I think that it will become clear that the analysis can be applied no matter how the rules are worded.



#### 4.1.2. Practice

Courts seem to forget about the public policy when ex-employers sue former managers on a fiduciary basis for post-employment competition.

The Supreme Court of Canada's analysis of the *Canaero* case<sup>31</sup> in 1974 is typical. Two "senior officers" of Canadian Aero Service Ltd. (Canaero) headed up a corporate attempt to negotiate a contract involving aerial photography and topographical mapping for the government of Guyana. They became discontented with various organizational problems within Canaero, incorporated Terra Surveys Limited and resigned from Canaero. Within four days after their resignations five corporations were invited to submit bids on the project: Terra was one of them. Terra's bid was accepted. The individual defendants and Terra Surveys Limited<sup>32</sup> were held accountable to Canaero for their profits from the contract. Mr. Justice Laskin explained how<sup>33</sup>.

[T]he fiduciary relationship goes at least this far: a director or a senior officer... is precluded from obtaining for himself... any property or business advantage either belonging to the company or for which it has been negotiating; and especially is this so where the director or officer is a participant in the negotiations on behalf of the company. ... [A] director or senior officer... is also precluded from so acting even after his resignation where... it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired. ... Although it was contended that O'Malley and Zarzycki did not know of the imminence of the approval of the Guyana project, their ready run for it, when it was approved at about the time of their resignations and at a time when they knew of Canaero's continuing interest, are factors to be considered in deciding whether they were still under a fiduciary duty not to seek to procure for themselves or for their newly-formed company the business opportunity which they had nurtured for Canaero. ... Liability of O'Malley and Zarzycki for breach of fiduciary duty does not depend upon proof by Canaero that, but for their intervention it would have obtained the Guyana project; nor is it a condition of recovery of damages that Canaero establish what its profit would have been or what it has lost by failing to realize the corporate opportunity in question. It is entitled to compel the faithless fiduciaries to answer for their default according to their gain.

31. *Canadian Aero Service Ltd. v. O'Malley*, *supra*, note 1.

32. It often happens that a former manager sets up a corporation in competition with an ex-employer. The courts rarely explain the basis of the new corporation's accountability. Essentially, it works somewhat like the common law tort of inducing breach of contract. One who knowingly contributes to a fiduciary's breach of duty incurs equitable obligations similar to the fiduciary's. Terra Surveys Limited knowingly participated in a scheme that would have made the two former managers accountable, and thus became accountable itself.

33. *Canadian Aero Service Ltd. v. O'Malley*, *supra*, note 1, p. 606.

Note how the analysis is focussed on what Laskin, J. identified as the “corporate opportunity”. No limits are set on how much profit must be accounted for. Did he think that all the profits gained from a “corporate opportunity” must be turned over, no matter how long it takes to earn them?

Other courts have taken positions on the corporate opportunity bandwagon.

In *Abbey Glen Property Corp. v. Stumborg*<sup>34</sup>, directors of the plaintiff corporation negotiated with a third party for a particular business deal on behalf of the corporation. The third party was more interested in dealing with the individual defendants, so they contracted personally. The deal was described as a “corporate opportunity” and the defendants’ profits were ordered paid to the plaintiff.

In *Moore International (Canada) Inc. v. Carter*<sup>35</sup> the facts were almost identical to those in *Canaero*, once it was concluded that of the three projects involved only one could be considered a “maturing corporate opportunity”. The individual defendants, C and R, were employed by the plaintiff corporation: C was the general manager and R was a senior salesman. Having worked for the plaintiff on a potential business project, C and R resigned and joined another corporation which successfully contracted for the project. The defendants were held accountable for their profit. This time, the reasoning was more in line with the two accountability tests set out earlier<sup>36</sup>.

[a corporate manager] is entitled after his resignation to assist his new employer who is already pursuing a business opportunity which his former employer was pursuing provided he does not use information concerning that business opportunity obtained during his former employment or his position with his former employer to obtain the business for his new employer.

Note, however, that once again there was no consideration of factors external to the equitable relationship between the ex-employer and former manager. The analysis suggests that the accounting remedy could apply to any amount of profit.

In *Roper v. Murdoch*<sup>37</sup>, the defendants were senior executives who attempted to negotiate with a television celebrity on behalf of the plaintiff

34. *Abbey Glen Property Corp. v. Stumborg*, (1976) 65 D.L.R. (3d) 235, app. dsmssd. (1978), 85 D.L.R. (3d) 35 (Alta. C.A.).

35. *Moore International (Canada) Inc. v. Carter*, (1982) 40 B.C.L.R. 322, app. dsmssd. (1984) 1 C.P.R. (3d) 171 (B.C.C.A.).

36. *Id.*, p. 344 R. was not a “senior officer”, but accountability for his activities seems to have been based on his knowing participation in what C, a senior officer and fiduciary, was doing.

37. *Roper v. Murdoch*, (1987) 39 D.L.R. (4th) 684 (B.C.S.C.).

corporation. The objective was to produce a television show. No agreement was reached. The defendants resigned and set up a new corporation, which hired the celebrity and produced the show. They were required to account for the profits earned by virtue of their appropriation of a "corporate opportunity".

In *Comedy Cottage Inc. v. Berk*<sup>38</sup>, a vice-president of the plaintiff corporation informed the corporation that a renewal of its lease had been refused. He resigned the same day, subsequently obtained the lease for himself, and formed a new comedy club. He was held accountable on the following grounds<sup>39</sup>.

In determining whether an officer may take advantage of a business opportunity in which a corporation is interested, courts consider whether the corporation had an interest, actual or in expectancy, in the opportunity and whether the acquisition thereof by the officer would hinder or defeat plans and purposes of the corporation in carrying on or developing legitimate business for which it was created. ... Even assuming arguendo that defendant did not begin competing for the lease until after his resignation, defendant remained bound by his fiduciary duty because his acquisition of the lease was based upon knowledge acquired during his employment.

There are lots more "corporate opportunity" cases, but these are a representative sample. Where the former manager earned a profit, it is taken away and given to the ex-employer<sup>40</sup>. Alternatively, equitable damages may be awarded to compensate the ex-employer. *Moore International (Canada) Inc. v. Carter* explained why<sup>41</sup>.

In my opinion the plaintiff is not required to elect one remedy or the other. He may lead evidence of both his own loss and his fiduciary's profit. And the trial judge may then make an award of compensation that is supported by the evidence. ... The fiduciary or his accomplice should not be permitted to gain from the breach of the fiduciary's obligation of trust and good faith. So, if their profit is greater than the loss by the former employer, an accounting is a better standard of compensation than damages. But, conversely, the employer should

38. *Comedy Cottage Inc. v. Berk*, 495 NE (2d) 1006, (Ill., 1986).

39. *Id.*, p. 1011.

40. There is, of course, room for argument in every case as to how much of the defendant's gross income was attributable to the "corporate opportunity" and how much of that can be deducted for expenses. The cases often go into great detail on these points. Evidence that profits were attributable to superior management by the defendant after his resignation, or by other factors not related to what he and the ex-employer were doing before he resigned, can also diminish the amount for which he is accountable. If the reported cases are typical, the latter point tends to be underplayed by defendants.

41. *Moore International (Canada) Inc. v. Carter*, p. 178. Similarly, see *CST Inc. v. Mark*, 520 A. (2d) 469 (Pa., 1987), in which a corporate officer was found to have appropriated a "corporate opportunity", but made no profit: damages equal to the estimated lost profit of the corporation were awarded.

not be penalized for any business ineptitude of the fiduciary or his accomplice. So, if the loss by the employer is greater than the profit of the fiduciary, damages would be the better standard of compensation. It follows that, where the evidence will support a sound assessment based on an accounting of profits and also a sound assessment based on a calculation of loss, and where, in the particular circumstances, both remedies are available and both are supported by the pleadings and the evidence, the compensation awarded should be the higher of the two.

Not all accountability cases involve a specific and identifiable "corporate opportunity". An ex-employer will sometimes sue a former manager who has been soliciting customers he used to deal with in his fiduciary capacity. It is often the case that the clients who were solicited are still with the former manager at the time of trial. Plaintiffs sometimes win. The amount of profits for which former managers are held accountable, and the losses for which ex-employers are compensated, are difficult to rationalize with any general principle. The following cases are typical.

In *Alberts v. Mountjoy*<sup>42</sup>, the defendants were employed by an insurance agent, M as general manager and B as a salesman. They left. M set up a new agency, employed B, and solicited many of the ex-employer's clients. Mr. Justice Estey conceded that "a departing servant has the right to compete with his former employer... by establishing a business in direct or partial competition and he may bring to that business the knowledge and skill directly obtained from the previous master in teaching him his business"<sup>43</sup>. However, M had used a list of customers taken from the ex-employer's office. Contrasting this with cases in which clients were solicited from memory, and citing several English cases, Estey, J. fixed liability on the ground that a former manager "is not entitled to make 'an unfair use' of information acquired in the course of his employment, nor may he use confidential information so acquired"<sup>44</sup>. Damages were assessed on the basis of loss of sales commissions suffered by the ex-employer for 2 years following the defendants' resignations. Where the 2 year limitation came from is not clear<sup>45</sup>.

---

42. *Alberts v. Mountjoy*, (1977) 79 DLR (3d) 108 (Ont.).

43. *Id.*, p. 112.

44. *Id.*, p. 115. It is unclear what he thought "unfair use" meant or what makes information "confidential".

45. There is a partial explanation at p. 120:

The evidence further indicated that when insurance agencies, well established such as in the plaintiff's case, are sold the purchase price thereof is twice the annual commission income. This formula is no doubt a recognition of the frailty of the trade connection in this kind of business between agency and client.

In *W.J. Christie & Co. Ltd. v. Greer*<sup>46</sup> a former manager left the plaintiff corporation, set up a competing insurance business, and solicited corporate clients. The issue was phrased in terms of whether the solicitation of clients was contrary to a continuing fiduciary responsibility owed by the former manager. The judge made a remarkable comment<sup>47</sup>.

There is nothing to prevent an ordinary employee from terminating his employment, and normally that employee is free to compete with his former employer. The right to compete freely may be constrained by contract. ... But it is different for a director/officer/key management person who occupies a fiduciary position. Upon his resignation and departure, that person is entitled to accept business from former clients, but direct solicitation of that business is not permissible. Having accepted a position of trust, the individual is not entitled to allow his own self-interest to collide and conflict with fiduciary responsibilities. The direct solicitation traverses the boundary of acceptable conduct.

The trial judge's assessment of damages for direct solicitation of former clients on the basis of one year's gross revenue (with an adjustment for overhead costs) was called "fair"<sup>48</sup>.

In *Dominion High-Rise Ltd. v. Night-Hawk Cleaning & Supply Co. Ltd.*<sup>49</sup> a manager quit and set up a competing business. The judge concluded that "while he continued to serve the company as manager... he did so with less enthusiasm": that, of course, suggests a failure to comply with fiduciary standards while still employed. There was also evidence of customer solicitation before he resigned—which the judge called "distasteful", noting that he was "receiving a somewhat considerable salary". Damages were assessed on the basis that what the defendant did "destroyed the plaintiff as a viable business entity", so a diminution in what the judge called "the value of the corporation" was calculated<sup>50</sup>.

46. *W.J. Christie & Co. Ltd. v. Greer*, (1981) 121 D.L.R. (3d) 472 (Man. CA).

47. *Id.*, p. 477.

48. Interestingly, the trial judge described his own assessment of damages in a different way. "As there was not any positive evidence as to the length of time the plaintiff would have retained the customers my decision must be based on interference and conjecture": *W.J. Christie & Co. Ltd. v. Greer*, (1980) 3 Man. R (2d) 431, p. 434.

49. *Dominion High-Rise Ltd. v. Night-Hawk Cleaning & Supply Co. Ltd.*, (1982) 37 O.R. (2d) 148 Ont.

50. *Id.*, p. 156. He dismissed alternative calculations on the ground that there was "insufficient evidence [so] the final figure arrived at, by this route, could only be an estimate, which is not good enough." Compare *DCF Systems Ltd. v. Gellman* (1978), 41 C.P.R. 2d 145 (Ont.), in which a director breached his fiduciary obligations by failing to attempt to prevent key employees from leaving or warning the corporation about their imminent departure. He subsequently resigned and joined them in competition against the corporation, but it seems clear that the issue was his failure to act while he still held his managerial position. Equitable damages were assessed on the basis of the capitalized

In *Hawboldt Industries Ltd. v. Chester Basin Hydraulics & Machine Ltd.*<sup>51</sup>, four management employees left the plaintiff corporation and set up a competing business manufacturing marine equipment. Their direct solicitation of the plaintiff's clients was held to be a breach of fiduciary obligation: it appears to have been assumed that they remained fiduciaries even after resigning<sup>52</sup>. Liability having been found, the task of assessing damages for breach of fiduciary duty was described as follows<sup>53</sup>.

The measure of damages is based upon the quantum of business actually diverted. The former employer has the burden of proving that direct solicitation of individuals occurred and the quantum of business that changed hands as a result of that solicitation. ... If it carries that burden, the Court should then be in a position to calculate the quantum of damages. If it does not carry the burden, there will probably be little, if any, damages payable.

Having said that, the judge based damages on the *defendant's* (not the plaintiff's) *ratio of gross profit to sales for a period of one year*. Net profit was estimated at 50% of that and was further reduced to account for the possibility that some of the plaintiff's business might have gone elsewhere even without the defendant's actions.

I can't make out how "damages" became equated with someone else's profit. Nor is it clear where the one year limitation came from<sup>54</sup>.

*White Oak Welding Supplies v. Tapp*<sup>55</sup> was another case where a former manager was assumed to be a fiduciary notwithstanding his resignation. The defendant, who was the plaintiff's sales manager and had an intimate knowledge of the plaintiff's business and customers, resigned

---

value of their work as employees, diminished by the 75% probability that they would have resigned even if the defendant had tried to persuade them to stay. The judge noted, at (p. 162-163): "it is in a high degree unlikely that the plaintiff companies would have retained much of the business that flowed to the defendants in the event of a perfectly proper resignation and the formation of a new business. ... An assessment based on lost revenue therefore does not constitute a realistic approach".

51. *Hawboldt Industries Ltd. v. Chester Basin Hydraulics & Machine Ltd.*, (1983) 22 B.L.R. 215 (N.S.).

52. It is not a matter of advertising to the public or to the trade as a whole; everyone has the right to advertise. What is forbidden is direct solicitation of individual customers of the former employer who may direct their business from the former employer to the former employees.

[*Id.*, p. 233]

53. *Id.*, p. 233.

54. Similarly, see *309925 Ontario Ltd. v. Tyrrell*, (1981) 127 D.L.R. (3d) 99 (Ont.), in which the defendant was found not liable for breach of fiduciary obligation. The judge estimated that the defendant would have been liable to account for 1 year of profits in the event of a different finding. No reason was given for using a one year period.

55. *White Oak Welding Supplies v. Tapp*, (1983) 42 O.R. (2d) 445 (Ont.).

and entered into competition, soliciting business from among the plaintiff's customers. Having concluded that a breach of fiduciary obligation had occurred, the judge assessed damages as follows<sup>56</sup>.

The amount awarded should, in my view, be based on the demonstrated loss of the plaintiff adjusted in several respects. First, ... competition in the welding business is very severe and client's accounts, in whole or in part (like hockey night in Canada), are constantly being captured and recaptured by the various competitors. *Secondly, the non-competition agreement which the defendant was at one time asked to sign, but which was in fact never executed, had in it a limit of one year from the time of resignation as the period during which the defendant would not compete. In my view, this furnishes a fair limit to the period during which losses should be charged to the defendant.* [emphasis added]

I see. One party once proposed that they agree to a one year term of non-competition. For whatever reason, they didn't agree. We don't know whether such an agreed term would have been a term of their contract or whether it would have been in violation of the public policy in favor of competition. At any rate, it is difficult to see how the fact that they once discussed (but did not agree) such a term has anything to do with equitable damages or fiduciary obligation.

In *57134 Manitoba Ltd. v. Palmer*<sup>57</sup>, the defendant was manager of the plaintiff's sales operations. He resigned and joined a competitor, taking several other employees with him. The competitor later stopped carrying on that aspect of business and helped the defendant set up a retail packaging business of his own. Once again we see a court concluding (i) that managers continue to be fiduciaries after they resign and (ii) former managers can't solicit the ex-employer's clients<sup>58</sup>. The judge made the following observation on the assessment of damages<sup>59</sup>.

I do not think it is possible to arrive at an accurate mathematical calculation of the plaintiff's damages. Instead, damages should be assessed, but they should be assessed with reference to the trends shown by the accounting evidence. This is not a case like *Canadian Aero v. O'Malley*, where a single specific business opportunity was wrongfully obtained from the plaintiff. The repeating nature of

56. *Id.*, p. 451.

57. *57134 Manitoba Ltd. v. Palmer*, (1985) 7 C.P.R. (3d) 477 (B.C.).

58. Absent a restrictive covenant, a mere employee may quit and go to work in competition with his former employer with few restrictions upon what he may do. By contrast, a former employee who held a management position owes a fiduciary duty to the former employer even after his employment is terminated and is more restricted in what he may do.

[*Id.*, p. 481] Similarly, see *Lacey and Lacey (Alex) Insurance Ltd. v. Stoyles*, (1986) 59 Nfld. & P.E.I. R. 181 (Nfld.), another case involving the insurance business in which a former manager was assumed to remain a fiduciary and was held liable for soliciting former clients from memory.

59. *Id.*, p. 495.

the plaintiff's business from year to year and the vagaries of commerce and customer connection require that damages be assessed rather than calculated.

And 5 years of estimated lost revenue was ordered paid to the plaintiff (plus 4 months of projected future losses)!<sup>60</sup>

Finally, in *Quantum Management Services Ltd. v. Hann*<sup>61</sup>, the defendants were managers in the plaintiff's personnel placement business. They had agreed to a restrictive covenant about future competition, but it was ruled not to be a contractual term because it violated the public policy in favor of competition. This led to some interesting (though, in my view, inaccurate) comments about the distinctions between contractual and equitable obligations<sup>62</sup>. The period of time used for calculating damages was described as follows<sup>63</sup>.

The next question is as to the period of time the fiduciary duty extended not to have commercial dealings with former Quantum clients. This question admits of no fixed answer — it is judgmental. In the circumstances of this case, particularly given the exclusive rights Hann and Taafe had with respect to their clients, I have determined that 9 months is the appropriate period.

I have fixed this period slightly longer than I otherwise would have in light of the unique relationship Quantum placement directors had with the personnel contacts of their clients. Otherwise, I would have fixed the period of disqualification at six months.

60. This, despite the judge's acknowledgment that "I am to balance the need of a company to impose a fiduciary duty upon its management employees recognized in *Canaero* against the need of the individual to earn a living after he leaves the employer, and the need of society to have that individual in productive employment". [*Id.*, p. 484.] Five years is a long time.

61. *Quantum Management Services Ltd. v. Hann*, (1989) 69 O.R. (2d) 26 (Ont.).

62. The common law adhered to the nineteenth century ideal of economic laissez-faire and promoted the value of free competition in the area of employer-employee relationships. It did so by finding most employment contracts with terms prohibiting post-employment competition invalid as being unreasonable restraints on free trade. ... Following the fusion (sic) of law and equity, the common law (sic) developed exceptions that favoured employers as opposed to employees. These exceptions are founded on the equitable concept of fairness and place fiduciary duties on departing employees not to compete with their former employers in prescribed circumstances. The first notable exception lies in the area of trade connections. The former employee may not solicit any customer whose name is contained on a list which the employee has taken from the employer.

[*Id.*, at p. 33.]

63. *Id.*, p. 35. Also, on p. 34 the judge noted that the "senior employee rubric applies to both Hann and Taaffe so as to preclude both of them from soliciting 'their' former clients at least for a reasonable period of time after leaving Quantum." The actual calculation was done by taking a percentage of the defendant's sales figures for the nine months and reducing the result by a further percentage to account for the possibility that some sales might not have been made by Quantum.



In sum, the cases are all over the map on accounting for profits and equitable damages. The public policy in favor of competition is rarely mentioned as a limiting factor : even when it is adverted to, it is not used.

#### 4.2. The errors in the practice

The courts have made two critical errors in analyzing the accountability of former fiduciaries who compete in business.

One error is to treat "corporate opportunities" as if they were property. They aren't. Yet note the words Bora Laskin used to describe the concept in 1974<sup>64</sup>.

[A] director or a senior officer... is precluded from obtaining for himself, either secretly or without the approval of the company... any property or business advantage either belonging to the company or for which it has been negotiating. ... What emerges from a review of the American case law is an imprecise ethical standard "which prohibits an executive... from appropriating to himself a business opportunity which in fairness should belong to the corporation".

It is notoriously difficult to figure out exactly what Bora Laskin meant in his reasons for judgment. Maybe he didn't intend later judges to conclude that he was advocating a property approach with his "corporate opportunity" doctrine. But they have certainly adopted his language<sup>65</sup>.

What courts are trying to describe with this recently fashionable label is nothing more than a potential business deal the corporation was working on. *Potential* is the key word. A corporate manager may well breach his fiduciary duty if he does not do his utmost to consummate the potential deal<sup>66</sup>; a former corporate manager may well be accountable if he takes advantage of information absorbed by virtue of his fiduciary position and undermines the potential advantage to the corporation by making a deal for himself<sup>67</sup>. But it is misleading to say that he "acquired"

64. *Canadian Aero Service Ltd. v. O'Malley*, *supra*, note 1.

65. I have already set out several of the subsequent Canadian cases. American courts are more explicit, relying on the same American precedents as the *Canaero* case. See, for example, *Comedy Cottage, Inc. v. Berk*, *supra*, note 38 at p. 1011, for the following novel conception of property. "It must be recognized that at least initially the Comedy Cottage possessed a protectable property interest in the expectancy that the lease of its place of business would be renewed. The acquisition of a lease of the premises by defendants hindered corporate plans to utilize the goodwill and public patronage built up during its many years of operation at the same location. Thus Berk had a duty to refrain from acquiring the lease at the expense of the corporation."

66. That was the basis of liability in *I.D.C. v. Cooley*, *supra*, note 23.

67. See the second of the two accountability principles set out above, under heading 4.1 "The rule". Accountability may result even if there clearly was no harm to the corporation: see *Boardman v. Phipps*, *supra*, note 24.

the information or “appropriated” the potential deal. Such terminology is useful in everyday speech, particularly where its emotive appeal is likely to help achieve some political end; but it will not do in legal analysis because “acquired” and “appropriate” are property words applicable only to proprietary claims. Mr. Justice Sopinka recently reminded us of the danger of assuming that because information is useful it must be protected by property rules<sup>68</sup>.

[A] man who thinks of a mechanical conception and then communicates it to others for the purpose of their working out means of carrying it into effect does not, because the idea was his (assuming that it was) get proprietary rights equivalent to those of a patentee. Apart from such rights as may flow from the fact, for example, of the idea being of a secret process communicated in confidence or from some contract of partnership or agency or the like which he may enter into with his collaborator, the originator of the idea gets no proprietary rights out of the mere circumstances that he first thought of it.

It doesn't matter whether the courts are really applying a property analysis or whether they simply see potential business deals as “sort of like” property<sup>69</sup>. What matters is what they don't do. They don't limit accountability in any principled way. The reason may be their “sort of like” property orientation. Recall an earlier conclusion: property occupies a special place in the common law system; an ex-employer can protect property, however acquired, but former employees who compete without interfering with the ex-employer's property are protected by the public policy in favor of competition. Thus, most former employees are at liberty to resign and use their skills and knowledge to compete. Any limitation on that liberty, whether an agreed limitation between the parties or a limitation based on equitable principles, is subject to the public policy in favor of competition. The “corporate opportunity” doctrine is one such limitation. Not being based on property, it is not exempt.

68. *International Corona Resources Ltd. v. LAC Minerals Ltd.*, *supra*, note 3, p. 81 per Sopinka, J., quoting from Lord Evershed in *Nichrotherm Electrical Co. v. Percy*, [1957] R.P.C. 207 (Eng.), p. 209.

69. Known, of course, as “quasi-property” to those common lawyers who prefer packaging and labelling to serious thought. Judges are inclined to the picturesque when trying to describe what they mean. See, for example, White's, J. description in *Re Berkey Photo (Canada) Ltd. v Ohlit*, (1983) 43 O.R. (2d) 518 (Ont.), p. 531.

There must also be the acquisition of a business opportunity or advantage which was available to the employer and not readily available to the competition. An example is a fresh corporate opportunity which has developed to a point where it is about to ripen. In that situation, if the employee quits so as to pick the fruit of the opportunity personally his conduct is improper and gives rise to liability.

Other cases talk of the ex-employer “losing the contract”, as if the business deal they were trying to arrange had been finalized before the former manager resigned.

The second critical error that emerges from cases in this area is the notion that a corporate manager's fiduciary duty continues to apply even after he resigns his fiduciary position. Again, this conclusion was extrapolated from the *Canaero* case<sup>70</sup>. But consider what the judges are saying. Does it make any sense that someone would owe fiduciary obligations *today* because he occupied a fiduciary position *yesterday* (or last week)? Mr. Justice Sopinka recently opened the door to an attack on this notion of lingering fiduciary obligation. His refreshingly well-reasoned analysis in *International Corona Resources Ltd. v. LAC Minerals Ltd.* invites a serious reconsideration of how former managers become accountable<sup>71</sup>.

Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics :

- (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.
- (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

It is possible for a fiduciary relationship to be found although not all of these characteristics are present, nor will the presence of these ingredients invariably identify the existence of a fiduciary relationship. ... The one feature, however, which is considered to be indispensable to the existence of the relationship, and which is most relevant in this case, is that of dependency or vulnerability. ... This condition of dependency moves equity to subject the fiduciary to its strict standards of conduct. Two caveats must be issued. First, the presence of conduct that incurs the censure of a court of equity in the context of a fiduciary duty cannot of itself create the duty. ... Second, applying the same principle, the fact that confidential information is obtained and misused cannot itself create a fiduciary obligation. ... In my opinion, both the trial Judge and the Court of Appeal erred in coming to the conclusion that a fiduciary relationship existed between Corona and LAC.

The connection between a "condition of dependency" and fiduciary obligation warrants further exploration. An armed bank robber doesn't

70. See, for example, *B. Love Ltd. v. Bulk Steel & Salvage Ltd. (No. 2)*, (1982) 40 O.R. (2d) 1 (Ont.), p. 5 per Gray, J. : "fiduciary obligations of a director or senior officer of a corporation may extend in time beyond the resignation or removal of an individual as a director or employee: *Canadian Aero Service Ltd. v. O'Malley and Dialadex Communications Inc. v. Crammond et al.*, (1987) 57 O.R. (2d) 746 (Ont.), p. 753 : "*Canaero* makes it clear that the duty survives the employment".

71. *International Corona Resources Ltd. v. LAC Minerals Ltd.*, *supra*, note 3, p. 67-69 per Sopinka, J., quoting in part from Wilson, J. in *Frame v. Smith*, [1987] 2 S.C.R. 99 (Ont.). Casual readers of the report may note that Sopinka, J. is listed as dissenting in the case, but on the issue whether there was a fiduciary duty McIntyre and Lamer, JJ. agreed with him to form a majority of the five judges who heard the case. Liability was found by a differently constituted majority on other grounds.

owe fiduciary obligations to the bank teller at the other end of the gun. Kidnappers don't owe fiduciary obligations merely because they can physically overpower their trussed up captives. A fiduciary is someone in a position of *legally condoned power*<sup>72</sup> who can affect the *legal* position of someone else<sup>73</sup> by *legal* means and who, *for those reasons*, is obliged to consider the best interests of that other person before doing so. Corporate managers fit that description; former corporate managers don't. That's why corporate managers fall within one of the traditional categories of fiduciaries, but former corporate managers don't.

What corporate managers sometimes do, however, while in the process of becoming former corporate managers (ie. immediately prior to resigning) is yield to temptation. A manager contemplating resigning may, for example, conclude that it is impossible to convince a potential customer to conclude a business deal with the corporation<sup>74</sup>, or may not work as hard as he could to close the deal<sup>75</sup>: a fiduciary who finds himself in such a situation of conflict between self-interest and fiduciary duty and

72. Mr. Justice Sopinka also touched on this point in *International Corona Resources Ltd. v. LAC Minerals Ltd.*, *supra*, note 3, p. 66, quoting in part from Southin, J. in *Girardet v. Crease & Co.*, (1987) 11 B.C.L.R. (2d) 361 (B.C.).

The word "fiduciary" is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth. But "fiduciary" comes from the Latin "*fiducia*" meaning "trust". Thus, the adjective "fiduciary" means of or pertaining to a trustee or trusteeship. That a lawyer can commit a breach of the special duty of a trustee, eg. ... by entering into a contract with the client without full disclosure... is clear. But to say that simple carelessness in giving advice is such a breach is a perversion of words. ... When the court is dealing with one of the traditional relationships, the characteristics or criteria for a fiduciary relationship are assumed to exist. In special circumstances, if they are shown to be absent, the relationship itself will not suffice. Conversely, when confronted with a relationship that does not fall within one of the traditional categories, it is essential that the Court consider: what are the essential ingredients of a fiduciary relationship and are they present?"

73. Suppose corporations A and B were bidding on a project. Corporation A, by submitting a more attractive proposal, will succeed in contracting for the project. That will affect what the legal position of corporation B "might have been in the future" had corporation B managed to conclude a contract for the project. But it certainly does not affect the legal position of corporation B in the way meant in the analysis of fiduciary obligations. Builders of better mousetraps don't owe fiduciary obligations to those to whose doors the public no longer beats a path.

74. That was what the manager decided in *I.D.C. v. Cooley*, *supra*, note 23: he was found accountable. This reasoning would also account for the decision in *Abbey Glen Property Corp. v. Stumborg*, *supra*, note 34, one of the "corporate opportunity" cases.

75. This was probably a factor in the *Canaero* case. It would also apply to at least two of the "corporate opportunity" cases set out earlier, *Moore International (Canada) Inc. v. Carter*, *supra*, note 35 and *Comedy Cottage Inc. v. Berk*, *supra*, note 38. An early example of this type of situation was *Cook v. Deeks*, [1916] 1 A.C. 554 (Ont., J.C.P.C.).

who later makes a profit which he might not have made but for that situation is made to account for the profit, regardless whether he was still a fiduciary at the time the profit was made. Alternatively, and regardless whether such conflict of duty and self-interest arose<sup>76</sup>, if a fiduciary in the course of performing his fiduciary duties encounters an opportunity to make a profit and later makes a profit that he probably would not have made but for that opportunity, he too is made to account for the profit, regardless whether he was still a fiduciary at the time the profit was made. The accountability rule serves to remove the temptation to exploit a fiduciary position. The purpose of taking the profit away is, as noted earlier, primarily *pour encourager les autres*.

On this view of the accountability rule there is no need to pretend that former corporate managers are still fiduciaries. Nor is there any reason to pretend that potential business deals ("corporate opportunities") are property. We simply are taking a profit away from a former fiduciary in order to help other fiduciaries perform their equitable obligations.

There remains one obvious question: by what rules does our legal system limit the accountability of former fiduciaries, in particular former corporate managers. One often forgotten rule evolved from the public policy in favor of competition.

#### 4.3. Applying the rule

The rule is exactly the same as in contracts, but it must be applied differently in Equity.

The rule can be stated as follows: the degree to which a former corporate manager can be made accountable for profits in Equity, or for equitable damages, is limited in geographical area and time; it must be "reasonable between the parties and with reference to the public interest"<sup>77</sup>.

---

76. It is the "potential" for conflict that matters: the equitable accounting rule is prophylactic in design. *Regal (Hastings) Ltd. v. Gulliver*, *supra*, note 23 and *Boardman v. Phipps*, *supra*, note 24, both resulted in an accounting of profits despite the fact that there was no real conflict. *Roper v. Murdoch*, *supra*, note 37, might also be explained on that basis.

77. The quote is from *Elsley v. J.G. Collins Ins. Agencies*, [1978] 2 S.C.R. 916, p. 923. It was, of course, said with reference to agreed terms between the parties (see *supra*, note 9). I simply take the position that the same principle applies in contract and Equity and am content to have others apply what follows to any alternative statements of the rule.

The rule must be applied differently in Equity because the issue is subtly different. A contracts case and an equitable accounting case start out with the same two basic questions: (i) does the former corporate manager owe the ex-employer money, and (ii) how much? The second question is moot unless the answer to the first is yes.

In a contracts case, the answer to the first question depends on the parties' contract. The answer obviously will be no if the parties did not put a term restricting competition in their agreement; even if there is an agreed term, it will not be a term of the contract if it violates the public policy in favor of competition. In short, the public policy issue is brought up by the first, not the second question.

In an equitable accounting case, the answer to the first question depends on proof that a conflict between self-interest and the former fiduciary duty led to the situation in which the profit was made or proof that the opportunity to make the profit can be attributed to the fiduciary position formerly occupied<sup>78</sup>. The public policy in favor of competition has nothing to do with either of those two issues. If it is determined that the former manager is accountable for profits, or owes equitable damages, the second question (how much?) must be answered. In short, in equitable accounting and equitable damages cases the public policy issue is brought up by the second question, not the first.

That makes a big difference. In a contracts case the ex-employer gets what the contract says. If it says no competition for six months in a particular city, the former manager must pay damages for any competition in violation of that term: no more is owed. If it says nothing, because an agreed term was struck out for violating the public policy, no damages are payable. However, in an equitable accounting or equitable damages case, the amount payable is the maximum allowed by the public policy in favor of competition.

An example will illustrate how this changes what a judge must do. Suppose a former manager made ten years of profits competing across Canada and has been found accountable. For how much of the profit is he accountable? Assuming that Canada is too large a geographical area and ten years is too long a time, the judge now must decide exactly how large an area and how long a time is allowed. There is no gray area as there was

---

78. See, *supra*, section 4.1. "The rule". I appreciate that some variation in the wording of the rules is required to handle equitable damages cases in which a former corporate manager would have been held accountable had he made a profit, or where his profit is less than the ex-employer's proven losses. That, however, is peripheral to the public policy point being made.

in the contracts case<sup>79</sup>. If the judge determines that everything that was done outside Quebec and after 3.5 years was protected by the public policy in favor of competition, the former manager is accountable only for the first 3.5 years of profits earned in Quebec.

That could require more detailed lawyerly analysis of the public policy in favor of competition.

#### **4.4. Summary: fiduciary obligation and public policy**

Way back in 1974 the Ontario Court of Appeal made the following comment<sup>80</sup>.

Fairness is the touchstone of equitable justice, and when the test of fairness is not met, the equitable jurisdiction of the Court can be invoked to prevent or remedy the injustice which misrepresentation or other dishonesty has caused. The category of cases in which fiduciary duties and obligations arise is not a closed one.

The comment has been repeated too often. They were wrong. We can only hope that the Supreme Court of Canada, while sorting out the legal affairs of LAC and Corona<sup>81</sup>, has managed to stop the trendy nonsense by which every bit of corporate or professional nastiness became labelled a breach of fiduciary obligation.

In the brave new world where "t'ain't fair" no longer suffices and when fiduciary obligations are more carefully thought out, I trust that some serious thought will be given to limiting the accountability of former fiduciaries. Corporate managers who resign and compete with their ex-employers are former fiduciaries. Their accountability is limited by the public policy in favor of competition.

---

79. See the concluding paragraph under section 3.3. "Applying the rule", *supra*.

80. *Goldex Mines Ltd. v. Revill*, (1974) 7 O.R. (2d) 216, p. 224, 54 D.L.R. 672 (Ont. C.A.), *obiter* (always *obiter*!).

81. *Supra*, note 70.