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When Former Employees Compete - Protecting Your Confidential Information

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The departure of a key employee, or an employee who has had access to sensitive information, can create legitimate concerns for an employer, especially when such employee directly competes with his/her former employer or is employed or otherwise engaged by a competitor of his/her former employer. The law provides certain protection for employers, but the limits of such protection are sometimes difficult to draw. The recent events surrounding CN Rail and its former CEO, Mr. Hunter Harrison, are a great example of some of these challenges.

CP Rail is involved in a proxy battle with Bill Ackman and his hedge fund, Pershing Square Capital Management, who question the efficacy of CP Rail's current management. Pershing began promoting the replacement of CP's current CEO, Fred Green, with Mr. Harrison who had retired from CN's top role at the end of 2009. Mr. Harrison publicly expressed interest in the opportunity and described his vision for CP and supposedly provided consulting services to Pershing in conjunction with its proxy battle against CP.

As a result, CN's board of directors decided to cancel Mr. Harrison's future pension payments, restricted share units and other benefits which, in total, were valued at approximately US$40M. This occurred prior to Mr. Harrison assuming the role of CEO at CP and even predated the CP shareholders' approval of the proposal. CN commenced legal proceedings before the Illinois Northern District Court on January 23, 2012 seeking a declaratory judgment confirming its right to suspend pension payments to its former CEO. At the time of publication, CN had not sought injunctive relief against Mr. Harrison.

In its case, CN took the position that Mr. Harrison was "intimately involved in every detail of CN's business" and that using such knowledge to assist one of CN's main competitors was a breach of his continuing obligations to CN. More specifically, CN alleged that Mr. Harrison was

in breach of both a non-competition provision tied to his pension arrangements as well as confidentiality obligations.

Although this matter is being litigated in the State of Illinois, it is an interesting case study of the application of the laws that relate to confidentiality, non-competition and non-solicitation. The focus of this article will be on the laws of Ontario.

All employees have a general duty of loyalty to their employers which prevents them from competing with their employer while employed. This duty does not extend beyond the period of employment. Moreover, although employers can rely on confidentiality obligations owed by former employees that extend beyond the period of employment, monitoring and enforcing compliance with such confidentiality obligations is elusive. In the employment context, such obligations usually do not extend to general “know-how” gained by an employee in the course of his or her employment.

Employers, therefore, often rely upon non-solicitation and non-competition obligations in their employment contracts or collateral agreements with their employees. The duration of the protection provided in Canada to trade secrets and confidential information is indefinite. However, the same cannot be said with respect to non-competition contractual obligations.

Non-competition obligations are unenforceable unless they can be shown to be reasonable in terms of geographic scope, activity that is restricted and the time period of the restriction. The courts will refuse to enforce any clause that comprises an unreasonable restraint of trade. Courts recognize every individual’s right to make a living in his or her chosen profession. By extension, a non-competition provision will usually be held as being unenforceable if a less onerous non-solicitation provision would have been adequate to protect the former employer’s legitimate interests.

A court’s assessment of the reasonableness of non-competition and non-solicitation provisions is stricter where such provisions apply to a former employee as opposed to an owner-manager who sells his/her business and received some benefit in conjunction with such sale. Irrespective, the concept of reasonableness in interpreting non-solicitation and non-competition provisions remains elusive.

What further complicates matters for employers is that in many Canadian jurisdictions, a non-competition provision that is determined to be unreasonable will not be amended by Courts. It will simply be struck in its entirety leaving the employer without recourse if the employee competes.

CN’s situation is somewhat different than what is typically seen with Canadian employers and their former employees. CN continued to pay Mr. Harrison benefits relating to his former employment. CN is taking the position that in consideration for receipt of such continued benefits there is an express (possibly buttressed by an implied) obligation for Mr. Harrison not to compete with CN. For former employees who do not have any continuing tie with their former employer, the former employer’s rights are a little less clear.

In certain Canadian jurisdictions, Courts have recognized the enforceability of continuing benefits that are conditional upon and tied to continued compliance with non-competition obligations where the inclusion of such clause is reasonable in the circumstances. One should distinguish the foregoing with the enforcement of a perpetual non-competition obligation; in the absence of a stipulated non-competition period (which is reasonable in the circumstances), former employees are free to renounce continued receipt of such benefits and compete with their former employer.

CN's situation is also interesting insofar as it relates to its former CEO; a person who was intimately involved in CN's strategic management and planning. The measure of reasonableness in such circumstances is particularly unique and distinguishable from most other positions. One could argue that a CEO's role makes it difficult for him or her to dissociate himself or herself from confidential information gained in the course of his or her employment and that confidential information would necessarily come into play if exercising the same role at a direct competitor of his or her former employer.

Although some employers such as Apple have instituted corporate policies which create firewalls between employees in different environments, perhaps in the hope of containing "natural" seepage of its confidential information through employee turnover, this tactic becomes less effective as one ascends the organizational chart and hierarchy.

To the extent such vulnerability does in fact exist, other than at a purely theoretical level, protection might be available in the form of fiduciary obligations. The concept of fiduciary duties has most often been applied with respect to assets and/or business or investment opportunities, but they have also found an application in conjunction with the employment relationship. It has been held that some employees, because of their key role within an organization and specific knowledge of its strategies, operations and opportunities, may be considered fiduciaries of their employer and prevented from competing or otherwise acting against the interests of their employer following the termination of their employment.

Notwithstanding, employee turnover at the CEO level is also a common reality in most industries. CN is not alone in taking legal action against its former CEO. Hewlett-Packard commenced legal proceedings against its former CEO who was hired by Oracle following termination of his employment by HP. That case was recently settled. Close on CN's heels, Acer also commenced legal proceedings against its former CEO when he began working for competitor Lenovo as chief of European, African and Middle East operations. In both cases, the former employer claimed breach of non-competition obligations based on a complex set of circumstances and legal arrangements.

Companies are perpetually trying to craft new ways of discouraging its former senior executives from jumping ship. It will be interesting to see whether traditional factors are applied to senior executives or whether they are varied or replaced by different factors altogether.