General knowledge acquired during employment not "confidential information", Alberta Appeal Court rules

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Is the accumulated knowledge about running a business that one gains through employment confidential business information? Will the use of this general business know-how by a departing employee for the purpose of starting a competing venture render the employee liable for damages to the former employer? In a unanimous ruling released November 20, 1996, the Alberta Court of Appeal said no.

The case, *Physique Health Club Ltd. v. Carlsen*, involved an employee, Carlsen, who, following a pay dispute, quit a position he had held with his uncle's company, Physique, to set up a competing business. Physique sued, claiming it had suffered significant losses due to the competition launched by Carlsen, and the fact that he had quit without giving notice.

TRIAL JUDGE: BUSINESS KNOW-HOW OBTAINED THROUGH TRIAL AND ERROR IS CONFIDENTIAL INFORMATION

In a controversial ruling, the trial judge found in favour of Physique, holding that Carlsen had a fiduciary duty to his employer, and that this duty had been breached by, among other things, Carlsen's use of confidential business information to launch his competing business. In holding that Carlsen owed a fiduciary duty, the court pointed to his status as an "enhanced manager", in whom the employer had placed great trust and to whom a large measure of independence had been given.

The court acknowledged that the information obtained and used by Carlsen was not confidential in the true sense of the word. However, it accepted Physique's argument that general business knowledge, gained over time, reduces both cost and risk, and increases the ability to compete. This, the court held, gives this type of knowledge an economic value which makes it "confidential in law even though it is not in and of itself confidential". It was not fair that a fiduciary in Carlsen's position should use this information to compete against his former employer.

The court rejected Carlsen's argument that such a ruling would result in a form of indentured servitude under which employees would effectively lose the right to compete or go into business for themselves. Employees had certain rights, the court responded, among them, the right to be entrepreneurs. But a balance had to be struck:

> "[E]mployers who foot the bill or make significant investments and turn the keys over,

> essentially, to enhanced managers to run operations for a considerable period of time have to have their investment protected in certain limited ways."

The court went on to hold that Carlsen should have given 12 months' notice before quitting, and awarded Physique $210,000. in damages.

COURT OF APPEAL: GENERAL BUSINESS KNOWLEDGE IS NOT CONFIDENTIAL

In overturning the trial judge's decision, the Court of Appeal assumed without deciding that Carlsen owed a fiduciary duty to his employer, and surveyed the legal principles that determine whether or not a fiduciary obligation has been breached. The court noted that one of these principles was that an employee must not disclose confidential information obtained during the course of employment. However, the court stated, the case law made it clear that this stricture applied only to information that was "special or peculiar" to the former employer, such as confidential customer lists or trade secrets. By contrast, an employee was free to use any skill or general knowledge acquired during employment. It was therefore clear, the court concluded, that the trial judge's ruling that business know-how was "confidential in law even though it is not in and of itself confidential" was in error.

On the notice issue, the court considered Physique's argument that Carlsen's fiduciary obligations continued throughout the notice period. During that period, Physique contended, Carlsen owed a duty to his employer not to compete. The court disagreed:

> "Absent misuse of confidential information, absent evidence that the employee took advantage of a business opportunity developed during employment or that he targeted customers of the former employer, there [is] no reason for the employee's obligation not to compete to continue beyond the term of the employment relationship. Failure to give proper notice is not, of itself, a breach of a fiduciary obligation, although it may be a breach of a contractual duty to give reasonable notice."

The court also considered whether a duty not to compete during the notice period would have been upheld had it been contained in a restrictive covenant in an employment contract, and held that it would not:

> "There is no evidence that there are any particular circumstances which make [Physique's] business particularly susceptible to competition by a former employee. There is no indication that trade secrets were exploited by [Carlsen], nor were [Physique's] customers solicited. If there had been a restrictive covenant in the employment agreement, the [employer] would not have met its onus in establishing that the restraint was necessary and did not go beyond the measures necessary to protect its interest."

The court concluded that six weeks' notice would have been appropriate in this case. However, it also

observed that, in cases where an employee provides insufficient notice, no damages will be awarded unless the employer provides evidence of losses suffered due to the inadequate notice. Here, no such evidence had been provided. Accordingly, the court granted the appeal and reduced the damages assessed against Carlsen to zero.

IN OUR VIEW

The fact that accumulated knowledge about running a business has economic value is not sufficient to make it confidential. To qualify as confidential, the information must be "special or peculiar" to the former employer, such as trade secrets or customer lists. (See also "The effective employment contract" on our Publications page.)

The Court of Appeal decision also suggests that it is probably wrong to calculate the appropriate notice period for a departing employee in the same manner as for wrongful dismissal, particularly in times of high unemployment. However, here, because the court held that the employer had not proven any damages due to the employee's sudden departure, it did not devote a great deal of consideration to the notice issue.

Employers who wish to protect themselves against unfair competition from former employees would be well advised to incorporate confidentiality provisions and restrictive covenants into employment contracts. While these have their limits – for example, a confidentiality clause will not prevent the use of general business know-how, and a restrictive covenant will only be upheld if it is reasonable in terms of scope and duration – they are effective tools to protect against the use of trade secrets, confidential information and trade connections.

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