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Ontario court orders subcontractor to pay damages to consulting firm for breach of confidentiality

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Governments and other large organizations often retain the services of consulting firms to assist them with their Information Technology systems. More often than not, the firm is retained after bidding successfully on a Request for Proposal (RFP) and is paid a *per diem* rate for the subcontractor, whom the firm in turn pays, after deducting a sum for overhead and profit. There is therefore a three-cornered relationship between the consultant, the firm and client government agency, involving two contracts, one between the government and the firm, and between the firm and the subcontractor, both of which are commonly subject to multiple renewals.

Not unlike many employment contracts, a common feature of the contract between the subcontractor and the consulting firm is a non-competition or non-solicitation clause providing that the subcontractor cannot renew his or her position with the government agency through another firm. This was the issue in *IT/NET Ottawa Inc. v. Berthiaume* (November 4, 2002), a case successfully argued by Jock Climie of Emond Harnden. IT/NET won a three-month contract with the "SXID" branch of Department of Foreign Affairs and International Trade in 1996. The defendant subcontractor in the case, Serge Berthiaume, was paid $500 per day, out of which $400 went to Berthiaume.

Berthiaume signed the firm's Master Agreement, which contained non-solicitation and non-competition clauses providing that during the period of the Agreement and for 12 months after its termination, he would not attempt to solicit business from any of the firm's "clients or prospects" without the firm's written consent. There was also a confidentiality clause which prohibited Berthiaume from divulging information about any of the firm's clients.

Berthiaume stayed on at SXID over the course of a number of contract terms, each one under an Appendix A to the Master Agreement. In June of 1998, Berthiaume approached IT/NET and asked for $450 a day. After some initial resistance, IT/NET agreed, and Berthiaume stayed on for another one-year contract between IT/NET and SXID. However, Berthiaume managed to avoid signing Appendix A, because he no longer wished to be bound by the terms of the Master Agreement.

In May of 2000, Berthiaume, who now wanted to be paid $500 per day, withdrew IT/NET's authority to use his name as a consultant for future RFPs. He had found Pertinex, a service provider, which was willing to take a smaller percentage of the contract price, leaving Berthiaume with $500. When IT/NET found out that Berthiaume's name was to be used in the other service provider's bid, it did not submit its own bid, as it believed that any bid which included a successful incumbent was bound to win out

over its competitors. IT/NET commenced an action against Berthiaume for breach of contract, citing the non-competition, non-solicitation and confidentiality clauses.

NON-SOLICITATION AND NON-COMPETITION CLAUSES UNENFORCEABLE

IT/NET was successful in court, and was awarded $22,000 in damages for breach of contract, and $2,000 in punitive damages. The court assigned a further $22,000 in court costs, for a total of $46,000. The principal issues before the court were whether the non-solicitation and non-competition clauses were enforceable and whether Berthiaume had breached his duty of confidentiality.

The court noted that while restrictive covenants in employment agreements are generally considered to be in restraint of trade and therefore void, if the employer can show it had a legitimate business interest to protect and that the covenant was reasonably necessary to protect the interest, the covenant will be enforced. The court held that IN/NET had such an interest, but that the covenant was too broad and ambiguous to be enforceable.

On the issue of the proprietary interest, the court noted that IT/NET had invested money and effort in matching Berthiaume to SXID with the reasonable expectation that it would recoup its expenses and earn a profit through repeated contracts with Berthiaume in the same position. This expectation was based on the "well-known reality" in the consulting business that a successful and valued incumbent is normally the person chosen by the client in subsequent RFPs. On the other hand, Berthiaume, through IT/NET's efforts, had the opportunity of learning about the needs of his work environment and developing personal relationships with key people at SXID. These factors demonstrated that IT/NET had a proprietary interest which required protection through a restrictive covenant.

However, the court held, while it would have been reasonable to have restricted Berthiaume from soliciting business from SXID on behalf of himself and another consultant placement firm, the non-solicitation and non-competition clauses at issue did more than this. These provisions read as follows:

4. The Subcontractor agrees that during this Agreement period, and for a period of 12 months after its termination, that s/he will not, directly or indirectly, on anyone's behalf (including, company, partnership, person or self):

    4.1 offer or cause to be offered, or to recommend, the offering of employment or subcontract services, to any employee or Subcontractor of IT/NET.

    4.2 he/she will not attempt to solicit business from any IT/NET clients or prospects without the written consent of IT/NET…

The court held that this wording had the effect of preventing Berthiaume from recommending a consultant working for IT/NET to another firm, even if that firm was targeting a client not being actively marketed to by IT/NET. Further, the term "clients and prospects" was undefined, and could capture many government branches and agencies. IT/NET was quite active in seeking contracts in the

Ottawa area, and Berthiaume could have no idea who these clients or prospects were. In the court's view, the mere fact that Berthiaume was working at SXID did not give him an unfair advantage in seeking work at another government job site.

Having found that the provisions were too broad and ambiguous to be enforceable, the court held also that the covenants were contrary to the public interest, in that they constituted too wide a prohibition against trade and competition.

DUTY OF CONFIDENTIALITY BREACHED

The relevant clause in the Master Agreement provided as follows:

5. The Subcontractor agrees and acknowledges that s/he has a fiduciary duty to comply with the duties found in this clause. The Subcontractor will not at any time, directly or indirectly, divulge to anyone (including company, partnership, person or self) either:

    5.1 any name, address or requirement of any customer of IT/NET;

    5.2 any process, method or device of IT/NET or other information, whether of the foregoing character or not, acquired as a result of his service;

    5.3 any of the financial affairs of IT/NET.

The court did not accept that Berthiaume had a fiduciary duty to IT/NET, as set out in this provision, but held that, both under the terms of the contract and under the common law, he was obliged not to exploit confidential information to the detriment of IT/NET:

> "Berthiaume became aware of SXID's needs for someone to fill the position he was in, he learned how much IT/NET had bid for the contract he was fulfilling, he learned about the technical aspects of IT/NET's proposal to SXID and he learned when that IT/NET-SXID contract was coming up for renewal. By sharing this confidential information with Pertinex, one of IT/NET's competitors, Berthiaume was able to give Pertinex a competitive advantage it would not otherwise have had. In fact, Pertinex would not have been aware of IT/NET's contract coming up for renewal and would not have been invited to respond to the RFP… The duty of confidentiality clause was included in the Master Agreement to cover precisely this type of situation. Berthiaume breached that clause."

The court found that, had Berthiaume stayed on at IT/NET, the contract would have been awarded to IT/NET. It found further that had Berthiaume simply left SXID, IT/NET would likely have been the successful bidder on subsequent SXID contracts, considering the relationship it had built with SXID during Berthiaume's tenure. The court therefore awarded IT/NET $22,000, being $50 per day for two years' worth of working days.

In making this award, the court rejected Berthiaume's argument that damages should be denied

because IT/NET had not submitted a bid against Pertinex. In the court's view, given that Pertinex was bidding Berthiaume's services, IT/NET had virtually no chance of success.

The court went on to award $2,000 in punitive damages against Berthiaume, because of what IT/NET claimed was the underhanded way in which he had tried to distance himself from the terms of the Master Agreement. The court agreed that Berthiaume should have advised IT/NET in 1998 that he was no longer prepared to accept another contract position under the Master Agreement:

> "Laying in wait to pounce on IT/NET at the end of a further two years of work through that firm with the arguments that the Master Agreement was no longer in effect and even if it were, the restrictive covenant under the Agreement was invalid, was a devious form of behaviour. Such behaviour justifies punitive damages…"

In Our View

Readers should note that while Emond Harnden represented IT/NET in this case, it was not responsible for drafting the contractual language which was the subject of criticism in the decision. This case points to the importance of proper drafting when dealing with restrictive covenants, as the court was quite clear in stating that such covenants, properly drafted, would have been enforceable in the context of this contractual relationship: there was no great imbalance in bargaining power between Berthiaume and IT/NET, and by observing a properly drafted clause, Berthiaume would not have been prevented from earning a living in his chosen field. As *FOCUS* readers were advised in "The effective employment contract":

> Assessing the reasonableness of restrictive covenants is largely a matter of balancing the right of the employer to protect its business interests from harm against the right of former employees to earn a living in their chosen fields. Covenants cannot be used simply to eliminate unwanted competition. Accordingly, employers have to establish that there is a demonstrable threat that must be countered and that the covenant goes no further than necessary to protect the interest at stake. Clearly, the appropriate response will vary with the type of business involved and the specific facts of each case.

For another case dealing with this issue, please see "Ontario Court of Appeal: restrictive covenant unenforceable" on our Publications page. For other cases related to confidentiality covenants, see ""Stealth and deceit": Ontario Court of Appeal slams ex-employees who exploited confidential information", "Employee making unfair use of confidential information must pay share of damages", "Manager, employee hit with damages for "unfair" use of confidential information" and "General knowledge acquired during employment not "confidential information", Alberta Appeal Court rules" on our Publications page.

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