LEGAL RIGHTS TO INFORMATION AND
SKILLED EMPLOYEES IN THE COMPUTER INDUSTRY

by

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THESIS ABSTRACT

Canada is currently experiencing the transition to a post-industrial society as the result of the widespread introduction of information related technologies. This thesis focuses on the legal rights to information of skilled employees who work with modern computer technology. The objective is to assess the adequacy of existing laws to meet the needs of employers and employees and to serve the public interest.

The initial chapters concentrate on the legal principles of trade secrets and breach of confidence as applied to the employment relationship. Patent and copyright protection for software is briefly reviewed but not emphasized.

Against this background, the major portion of the thesis examines the delicate balance between the legal interests of the employer, the employee and the public. Any attempt by employers to limit post employment use of information by employees invokes the doctrine of restraint of trade. This doctrine recognizes an employee's right to use the knowledge and skills developed during employment for the benefit of other employers. The thesis examines the elements of the restraint of trade doctrine as applied to skilled employees in the computer industry.

The creation and development of software is used throughout the thesis to illustrate legal principles. Employers such as software developers are extremely vulnerable to misappropriation of confidential information by their employees. Such employers rely heavily upon the use of restrictive covenants in employment agreements to limit disclosure and to prevent future competition.
The remedies for an employee's breach of confidence are reviewed. This chapter concludes that the legal principles governing interlocutory injunctions are inadequate to properly protect the information employer.

The thesis concludes that the present Canadian law is increasingly inadequate to protect a computer industry employer against an employee's unauthorized appropriation of confidential information. In short, the law has not yet recognized the social and technological changes that have greatly increased the vulnerability of the information employer.

If neither the courts nor the legislatures take action, information employers will have to further increase their reliance on the limited and uncertain protection of restrictive covenants in employment agreements.

THESIS SUPERVISOR:

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I. INTRODUCTION

A. THE POST INDUSTRIAL INFORMATION SOCIETY

"In the midst of the computer age, we are often startled witnesses to the radical changes taking place around us. Patterns of doing business, which have evolved slowly over many generations, are being inextricably altered almost overnight. Although it may be difficult to imagine, the day will come, and some speculate before the end of the century when many of us will work, shop, bank and take classes seated at a computer terminal in our homes.

The scope of these changes and the speed with which they are occurring will have enormous implications for the structure of society. Often spoken of as a revolution, the development of microelectronics will have a worldwide impact that is at least as powerful and far-reaching as the development of the printing press." ¹

One wonders if there is any Canadian who has not yet heard about the information revolution. Numerous commentators in both the popular media and in academic literature tell us about the transformation from a smokestack industrial economy to a "high tech" information economy. ² Alvin Toffler, in his book entitled "The Third Wave" refers to the countries of the world as either "first wave", "second wave", or as "third wave" societies.³ In this simple but effective metaphor, those nations labelled as "first wave" are still experiencing the transformation from hunting activities to an agriculturally based economy. Second wave countries are those undergoing the changeover from agricultural economies to industrialization. Nations such as the United States, Japan, West Germany and the United Kingdom, which are leading the world in the use of electronic technology, are the third wave countries.

Although Canada cannot be easily labelled as either a completely industrialized economy, or an economy based on microelectronics, the
Current advances in telecommunications and in computers are revolutionizing our lives. Numerous reports and articles document the significant changes that are occurring in the Canadian economy. In the past the goods producing industries were considered to be the heart of the economy. Growth of the manufacturing sector was the key to prosperity and the solution to the problem of unemployment. But industrial growth no longer dominates the Canadian economy. A recent study conducted for the Ontario government shows that "information related activities account for close to half the Gross Domestic Product. The information economy - that part of the G.D.P. associated with the production, processing and distribution of information goods and services accounted for 47% of the G.D.P. in 1981, up from 35% in 1971..."

Canadians can no longer look to the manufacturing sector to create jobs for those entering the labour force. Intense foreign competition is forcing our manufacturers to use the developing electronic technology. Computer assisted manufacturing (CAM) and robotics must be used on the plant floor, while office automation confronts the white collar worker. Canada is presently at the change-over point in industrial production where diminishing amounts of labour are needed to produce a constant quantity of goods. Just as mechanization converted farming from being labour intensive to being capital intensive, the new technology is converting the manufacturing process.

The remarkable fact is that the service sector now dominates the North American economy. Estimates are that in 1982 services generated 67% of the U.S. gross national product, and employed seven out of every ten Americans. While employment in the manufacturing sector has remained
constant for the last decade, service related jobs in the U.S.A. have gone from an estimated 47 million to 65 million.\(^5\)

It is the service sector that best demonstrates the changeover to an information economy in Canada or the U.S.A. Economists divide this sector into two major areas: intermediary services and consumer/community services.\(^6\) A closer look at the industries represented in these categories points out the enormous information component.

The intermediary services category includes distribution services such as transportation, utilities, wholesale and retail activities, and general business services such as finance, insurance, legal, and all the other supporting professional businesses. Consumer and community services covers all activity in the fields of entertainment, hotels, real estate and also includes all government programs.

One common link among all of these sub-categories is information. All of these are either information dependent or else deal solely in information as a basic stock in trade. Accordingly, these businesses are responding enthusiastically to the new information technologies. Computers enable the service sector to process, evaluate and distribute vast amounts of data. Telecommunications link the data bases and computers together in an ever expanding networks.

Canadian policy makers cannot afford to ignore the impact of microelectronics. The new technologies are advancing so rapidly that enormous social and legal changes appear to be inevitable. The following comparison captures the relative speed and power of the forces behind the movement to computerization. "If the aircraft industry had evolved as spectacularly as the computer industry over the past twenty-five years, the Boeing 767 would cost $500 dollars today, and it would circle the
globe in twenty minutes on five gallons of fuel. Such performance would represent a rough analogue of a reduction in cost, the increase in speed of operation, and the decrease in energy consumption of computers.\textsuperscript{7}

B. THE SIGNIFICANCE OF INFORMATION

What is information? Does the term have a different meaning depending on the context? Has the definition changed over the past decade? The word is widely used, but a multiplicity of meanings come to mind. Information seems to be one of those enigmatic terms that acquires meaning from its surroundings.

Information has not yet been strictly considered or defined in Canadian case law. For example, the general concept of information is not referred to in either the Canadian Law Dictionary\textsuperscript{8} or the Words and Phrases section of the Canadian Abridgement.\textsuperscript{9} (The obvious exception is the very specific definition given to the word in the criminal justice process in referring to the document which sets out the criminal charges against an accused.)\textsuperscript{10}

A non-legal definition for information from a general dictionary explains the concept as "knowledge acquired or derived; facts" or else as "timely knowledge; news".\textsuperscript{11} But this type of explanation lacks the precision and accuracy that is required for any discussion of legal rights to information.

This thesis will focus on the rights to information in the computer industry, and particularly upon the obligations of secrecy and confidence that an employer can legally enforce against an employee. Therefore information must be defined at least in this limited commercial context. However, even with these limits, a precise definition still eludes legal
commentators. In a recent article, Hammond avoided such an attempt and instead identified information as a continuum "which runs from pure ideas through information, data and know-how, and into the areas conventionally covered by the statutory monopolies." In this context, the statutory monopolies mean the rights of patent and copyright holders under the federal legislation.

The concept of information only acquires a degree of precision when it is used in the technical sense. The glossary for the 1983 Computers and Law Institute provides the following explanations of information and its related terms:

- data processing system - a network of machine components capable of accepting information, processing it according to a plan, and producing the desired results.

- information - the meaning derived from data which has been arranged and displayed in such a way that it can be related to that which is previously known (cf. data).

- information system - a logical group of subsystems and data required to support the information needs of one or more business processes.

- information system network - a network of multiple operational-level information systems and one management-orientated information system (centred around planning, control and measurement processes.) The network retrieves data from databases and synthesizes that data into meaningful information to support the organization.

To illustrate the obligations of secrecy and confidence in the ensuing pages, this thesis will refer to one specific type of electronic information, namely software. In the computer terminology, software means the set of electronic instructions that tell a computer what function it is to perform. Brooks identifies different types of
Software such as systems software, application software, listings, and updates and program modifications. However, the precise distinctions are unimportant for the purpose of this thesis. The term software was coined to contrast computer programs with the "iron" or hardware of a computer system.

Software provides a dramatic and effective illustration of information rights. It is a type of electronic information that plays an increasingly important role in the emerging high technologies. The production of software is labour-intensive rather than capital intensive, and so provides a relevant background for the conflicts between the rights of employers and employees in the computer industry. Thus, software illustrations will be used to explore the application of the law to the high technology employer and employee.

Admittedly, the definitions of software and information offered above are vague and legally imprecise. The terms only take on any degree of certainty when used in a narrower technical sense. The concepts have not yet been defined in non-technical language that is both completely accurate, and still comprehensible to a non-technical outsider. In effect, our society and our legal system have not yet come to grips with the significance of electronic information as a mass produced product or as a valuable social resource.

An example from a related profession will illustrate the difficulties of dealing the new information economics. The accounting profession in North America is currently debating the application of accounting principles to software. One particular disagreement relates to the appropriate classification of software in the financial statements of software development corporations. The classification issue is
significant because of the large amounts of money that is spent by these corporations on the research and development of new software programs.

The currently accepted Canadian practice is to treat software development costs as an expense in the year incurred.\textsuperscript{16} Thus, the profit and loss statements of the corporations show huge expenses during the initial years of the life of a successful program. The contrary view is to treat the disbursement as the acquisition of a capital asset. This approach means that the cost of the asset can be depreciated on a year by year basis over the life of the software program.

Comserv, Inc. is an American based maker of software systems for manufacturing companies. It invested the sum of $735,000.00 in 1981 and 1982 to develop a program for purchasing procedures.\textsuperscript{17} When Comserv launched the product in 1982, the corporation had already received firm orders for 35 sets of the program at $40,000.00 each for a total of $1.4 million dollars. By the end of October, 1982 sales had reached a total of 70 systems for a total of $2.8 million in sales revenue. The chief executive officer of the corporation estimated that the purchasing program would generate at least $6 million dollars more in revenue before the product was outdated. Given these facts, the corporation's auditors, Peat, Marwick, Mitchell & Co., considered the program to be an asset of the corporation for the annual financial statements.\textsuperscript{17a}

Financial statements for such companies change drastically if software houses are expected to expense software costs on an annual basis instead of treating the programs as depreciating assets. In Comserv's case, reporting all of its 1981 development costs as an annual expense would have converted a 1981 reported profit to a $1.0 million loss. In the year 1982 when even more development work on a number of programs was
undertaken, treating research and development costs as current expenses would have changed a profit of nearly $2.5 million dollars to a loss of almost $4.0 million. 17b

The Comserv situation shows the accounting profession trying to deal with information in the modern economy. If the normal rules of conservative accounting had been followed, the result would have been illogical. Comserv would have generated $6.0 million in extra revenue by selling information that was not listed as a corporate asset.

Perhaps these contradictions can be explained as an inappropriate application of accounting rules. But another explanation is that the accountants are no different than most groups in our society. The normal response is to treat information production and distribution as no different than any other industrial product. By fitting information into familiar, comfortable categories, the impetus to change is resisted. The result is to avoid any change in the existing rules.

Lawyers must now begin to deal seriously with the impact of electronic information. In conjunction with the rest of Canadian society, we must determine whether the existing rules of law can accommodate the emerging information economy, or whether the rules of law must change.

C. THE LEGAL PARADIGM AND THE CHALLENGE FOR LAWYERS

A paradigm can be described as an individual's set of attitudes or a way of thinking that determines that individual's response to a particular event. 18 Since the legal profession holds strongly to certain shared attitudes and beliefs, the profession can be said to approach problems with particular and distinctive paradigms. In this way the emphasis on
stare decisis in the English common law is a well articulated paradigm to solve new cases.

The risk involved in this rear-view mirror approach to problems is that lawyers may not catch the scope of a social change nor see the real legal and policy issues that are involved. In particular, Hammond observes that the legal profession customarily treats information as a type of property, and takes issue with this easy classification.

The history of legal responses to new information and knowledge suggests two critical challenges. The first relates to the ability of the profession and the commercial community to devise new social arrangements that will ensure both the creation and the effective and profitable utilization of new information and technology. The second challenges a liberal society to protect its basic political and human values from unwise applications or withdrawals of that new knowledge. The real question is whether the institution of 'property' is an appropriate vehicle for addressing those challenges.19

Canadian society now confronts the two critical challenges identified by Hammond. One area that tests our ability to use new information creatively while simultaneously protecting basic political values is the recent freedom of information legislation enacted by the federal government.20 As Hammond predicted, the issue of access to information is becoming an obvious change in the levels of formal legal ordering.20a

The North American experience with access to information legislation indicates that legislators and lawyers have not as yet entirely met Hammond's challenges. In the United States, the Freedom of Information Act21 was enacted in 1966. The basic purpose of the legislation was to "ensure an informed citizenry, vital to the functioning of a democratic society, needed to check against corruption and to hold the governors accountable to the governed".22 This objective may have met Hammond's
first challenge of preserving basic political values in the United States. But constant criticism has been directed at the legislation for its failure to ensure the fair and effective use of commercial information in the United States. These widespread complaints have been generated by the fact that the legislation permits violations of corporate privacy or corporate confidentiality. These alleged violations occur after corporate trade secrets or confidential information have been disclosed to the government. Competitors of the trade secret holder then use the Freedom of Information Act to obtain the trade secret from the government. The American legislation does contain exemptions for third party trade secrets, but "recent decisions of the U.S. Supreme Court have underscored, and perhaps enhanced, the vulnerability of Government held trade secrets to public disclosure."

The Canadian counterpart to the American freedom of information legislation was proclaimed in July, 1983. The announced purpose of the Access to Information Act was to improve our democratic process by expanding the flow of information to Canadian voters. Yet even before the legislation was proclaimed, Canadian legal critics attacked the bill for its threat to corporate confidentiality.

Relying upon the American experience, these critics claim that most freedom of information enquiries are not seeking government information. It is alleged that 80% of the requests for information made to U.S. federal agencies (excluding F.B.I. and C.I.A. enquiries) have been made by businesses seeking information about the secrets of their competitors. Although neither the Canadian or American governments intended such results, the legislation appears to legalize a certain amount of industrial espionage.
The foregoing debate indicates that our legislators may have underestimated the significance of these new laws in an information economy. The Canadian statute opens the doors to the huge quantities of information stored in the government data banks. The federal government plays a major role in many sectors of the Canadian economy and participates in a multitude of joint ventures with the private sector. As a result of the legislation, the records of 27 Ministries of State and 106 other government institutions are now subject to public disclosure.

Even though the Canadian legislation contains exemption provisions for corporate trade secrets in section 20(1), at least one leading corporate counsel doubts the effectiveness of these protections. The doubts appear to have some foundation. For example, the exemptions to protect confidentiality are subject to an override provision. Section 20(6) allows legitimate corporate secrets to be released when the disclosure would be in the public interest as it relates to the public health, public safety or protection of the environment. This same subsection also permits release of confidential information where the public interest clearly outweighs the financial loss, prejudice to the competitive position, or interference with the contractual negotiations of a third party. Another discouraging aspect are the limitations placed upon a party who has been injured by a mistaken disclosure of information. Section 74 prohibits any civil action for the recovery of damages caused by an erroneous disclosure by a government employee so long as the disclosure was made in good faith.

Recent case law confirms that the overriding objective of the Access to Information Act is the disclosure of information. In Re Maislin Industries Ltd. and Minister for Industry, Trade and Commerce, Regional Economic Expansion, the Court emphasized two principles that are to be
applied to any attempt to use the exemption in s. 20(1) to protect confidential information or trade secrets. First, since the statute codifies the right of public access to government information, such "public access ought not to be frustrated by the courts except on the clearest grounds so that doubt ought to be resolved in favour of disclosure". Second, the court placed the burden of persuasion upon the party resisting the disclosure of the information.

To return to Hammond's two critical challenges for the legal profession, we can again ask whether the Access to Information Act "ensures the creation and ...utilization of new information"? Does the statute protect "against unwise...withdrawals of ...new knowledge"?

The apparent conclusion forced upon us is that certain of the assumptions underlying the Access to Information Act are unrealistic. Canadian legislators may have seriously underestimated the value of information in our society. The property paradigm and unfamiliarity with the economics of information seem to have created new and unforeseen problems. Working from attitudes conditioned by an industrial society, our legislators thought the statute would redress the imbalance between the individual and the federal bureaucracy. Their intention was that the statute would extend the citizen's property rights to information held in the government files.

However, if the critic's claims are correct, the first major Canadian legislation in the information field has serious economic consequences that are counter-productive. Instead of a statute that encourages the free exchange of information, we have enacted a law that encourages businesses to avoid disclosure and to label information as confidential. Instead of a statute that encourages industry and government cooperation,
we have a law that discourages business from participating in frank and open discussions with government. Finally, there is a clear risk that the statute allows legalized industrial espionage. An unethical competitor may yet be able "to reap where it has not sown."

Canadians are now facing the difficult task of converting to an information economy. We must therefore examine our existing paradigms to avoid making any unintended yet costly social errors. Achieving the transformation to a computerized society with minimal social costs is important for our domestic harmony, and critical for our international competitive position.

The thesis is part of the transition process to an information based society. The subsequent chapters examine the relationship between the law and information in the computer industry. The precise focus is on the employer and employee situations where legal rights to information are a predominant concern of the parties. The central question will be an assessment of the adequacy of existing laws to meet the needs of employers and employees, and to serve the public interest.
FOOTNOTES: CHAPTER I


4a A. Silversides, Study finds a Significant Shift Toward Information Economy, Globe and Mail, June 22 1984, at 12.

5. Forbes magazine, You Mean We've Been Speaking Prose all These Years?, April 11, 1983 p. 142.

6. Id., at 144-145.


10. Id., at page 236.


14. Id.

14a. For an extensive discussion of the problems in defining software see J. Palmer, R. Resendes, Copyright and the Computer (1982) Consumer and Corporate Affairs/Canada at p 5-15. A general definition of software provided by this study at pg. 6 was "a set of precise instructions that tells the computer how to solve a particular problem."


17a. Id.

17b. Id.

18. Supra, note 12, 49.

19. Supra, note 12, 52.


20a. Supra., note 12, 50.

21. 5 U.S.C. Section 552.


25a. Supra., note 20

26. Section 2(1) of the Access to Information Act provides:

The purpose of this act is to extend the present laws of Canada to provide a right of access to information in records under the control of a government institution in accordance with the principles that government information should be available to the public, that necessary exceptions to the right of access should be limited and specific and that decisions on the disclosure of government information should be reviewed independently of government.


28. Id., Both of the articles noted use the 80% figure.

29. Id., Ross W. McFarlane is corporate counsel for General Motors of Canada Ltd.


29c. Id. at 420.

29d. Id. at 420. One possible limitation on the disclosure of confidential information is that the information must exist in the government data banks in the compilation or format requested by the

29e. Supra., note 12.

II  WHO QUALIFIES AS AN EMPLOYEE?

A. GENERAL CONSIDERATIONS

The Information Revolution has changed the nature of employment in our society. While many unskilled as well as managerial jobs are being eliminated, the increasing use of computers has dramatically raised the demands for highly trained researchers, engineers, technicians and programmers.\(^1\) These are the key employees who are charged with the design and development at each new generation of technology. The booming Northern American computer industry also employs legions of other people in the ancillary areas of marketing, customer support, maintenance, finance and accounting.

The skilled employees who first develop the technology, and then later distribute the software and hardware to the customers normally obtain access to the employer's confidential product information. The competitive demands for their talents and the quickly changing structure of the industry also means that the skilled employees are highly mobile in the labour market. When they move to a new employer, the knowledge of the product information of the previous employer moves with them. This thesis will examine the extent to which an employer can impose obligations of confidence and secrecy upon his former employees.

This thesis deliberately concentrates on information rights in the employment relationship. However, this focus does not assume that the employment relationship is the only means to organize the production of information in the computer industry. The legal categories of partnership, independent contractor, incorporation and principal/agent are other ways to organize the development of hardware and software. However, these separate categories must be distinguished from the employment relationship.
Apart from the motives of business strategy, there are important legal reasons for separating employees from agents, partners and independent contractors. While all of these groups face obligations under the doctrine of breach of confidence, there are legal subtleties peculiar to each group and particularly to employees. Therefore, the precise obligations imposed on any information worker cannot be determined without first examining that individual's legal status. Is the person operating as an employee, an agent, a partner or a independent contractor?

An employee differs from the other groups for the following reasons. An employee must comply with obligations of loyalty and good faith that are implied as part of the employment contract, whereas an independent contractor can more freely pursue his own self-interest. On the other hand, an employee is rarely fixed with the same onerous fiduciary obligations that are placed upon agents, or upon directors and senior officers of a corporation. Similarly, an employee faces different legal obligations than those imposed upon a partner. Unlike partners, an employee and employer are not "carrying on business in common with a view to profit", and an employee is not fixed with a partner's joint and several liability for all the debts and liabilities of the partnership.

The employment relationship also receives distinctive treatment under the doctrine of restraint of trade. Subsequent chapters will point out that although the doctrine applies generally to other relationships such as partnership, independent contractor/contractee and the sale of a business, a more rigorous scrutiny is given to employment restraints in contrast to other types of restraints on trade.

It is even argued that the "reasonableness test" when applied to an employment restraint should be considered against the equitable standard
unconscionability. Many courts that are less adventurous still start with the assumption that employment restraints are prima facie void. This initial assumption is in clear contrast to the more deliberate analytical approach taken on other restraints such as solus agreements.

One final reason for determining an individual's legal status arises from the Copyright Act. Copyright protection for software is increasingly important in Canada due to the size of the market. Section 12(3) of the Act provides a presumption of ownership of copyright for an employer.

In summary, a skilled employee in the computer industry occupies a different legal position than agents, independent contractors or senior officers and directors.

A dramatic illustration of this point was provided by the 1981 judgement of Reid J. in Investors Syndicate Ltd. v. Versatile Investments Inc. The plaintiff had applied for an injunction to prevent one of its former sales representatives from selling account lists to the corporate defendant. At trial, the injunction was refused on the grounds that the sales rep was an employee and that the restrictive covenants in the employment contract were unreasonably restrictive.

On appeal to the Ontario Court of Appeal the plaintiff was successful, but on somewhat surprising grounds. Although the argument had not been raised in the lower court, the Court of Appeal was persuaded to classify the sales rep as an agent of the plaintiff. As an agent the salesman was bound by wider fiduciary obligations than those of a lower level employee. He was not permitted to place himself in a position of conflict with his former principal. Thus, the legal status of the individual salesman directly affected the legal protection that was applied to vital business information.
B. THE JUDICIAL TESTS FOR DETERMINING STATUS AS AN EMPLOYEE

The courts cannot determine employment status simply by looking at a general definition of an employee. Such definitions are only generalizations of the specific judicial tests, and must be treated with caution. For example, an employee has been defined:

"as an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract with an employer, whether the contract is for manual labour, clerical work or otherwise, is expressed or implied, oral or in writing, and whether it is a contract of service or apprenticeship."15

This definition then distinguishes between a contract of service and a contract for services.16 Thus, a servant or employee is a person "subject to the command of his master as to the manner in which he shall do his work". In contrast, the independent contractor "in the actual execution of the work ... is not under the order or control of the person for whom he does it."17

This definition highlights the control element, and therefore is only a diluted version of the widely recognized control test.

Instead of definitions, what are the judicial tests that determine whether a person is an employee as distinct from an independent contractor, an agent, or a partner? The general answer is that the common law has not adhered to one static test for identifying the employment relationship. Rather the English and Canadian courts have shown a definite willingness to adjust to changing economic times. Instead of adopting one rigid formula, a variety of tests have been used in recent decisions. Appeal court decisions have also been careful not to make authoritative statements adopting any one test that necessarily excludes the others. The judgement of Lord Wright in Montreal v. Montreal Locomotive Works Ltd. demonstrates this flexible attitude.
In earlier cases a single test, such as the presence or absence of control, was often relied on to determine whether the case was one of master and servant ... In the more complex conditions of modern industry, more complicated tests have often to be applied. ... In many cases the question can only be settled by examining the whole of the various elements which constitute the relationship between the parties.18

Aside from the acceptance of multiple tests, Lord Wright's statement also indicates that the existence of the employment relationship is primarily a question of fact. After the initial determination of the relevant factors, then the contract is to be construed in the light of the circumstances governing the relationship.19

Due to this factual approach, the courts frequently ignore the labels which the parties have attached to the contract in question. The proper approach looks past the formalities to examine the substance of the relationship between the parties. The Ontario Court of Appeal recently upheld a decision of a Referee who ignored the express recitals and provisions of a contract. As a result the individuals were held to be employees rather than wholesalers as stipulated in the contract. Lacourciere J.A. stated that:

Further, we see no error in the use of the written contract made by the learned Referee. He was quite right in looking at the effect of its provisions rather than at its formal recitals. ... The Referee did not ignore the terms of the contract where they evidenced the conduct of the relationship between the parties; he merely disregarded the recitals and provisions purporting to provide for the purchase and sale of the newspapers by the circulation managers as wholesalers. The recitals and provisions were not in accordance with the facts, ... 20

In summary, Canadian courts have followed Lord Wright's acceptance of multiple tests for determining the employment relationship. This chapter now examines the three most widely used tests.
C. THE CONTROL TEST

Western Canadian courts have long been using the control exercised over the conduct of work as a dominant factor in testing the existence of the employment relationship. The 1913 decision in *Re Western Coal Co.* reflects a typical early emphasis on the right of the employer to direct the work.

The extent of the right of control seems to be the important question in distinguishing between the position of a servant and that of an independent contractor, ... There seems no more reason for refusing to recognize as holding the legal position of servant and to recognize his compensation as wages, a teamster using his own wagon and team, than a carpenter using his own tools or a laborer his own spade. The predominant and prevailing element in each case is the personal service, and a personal service which is subject to the direct control of the employer.

This judicial approach was summarized in the 1946 House of Lords decision in *Short v. Henderson Limited* per Lord Thankerton:

[L]et me recapitulate the four indicia of a contract of service derived by the Lord Justice-Clerk from the authorities referred to by him: these are (a) the master's power of selection of his servant; (b) the payment of wages or other remuneration; (c) the master's right to control the method of doing the work; and (d) the master's right of suspension or dismissal. The learned Judge adds that a contract of service may still exist if some of these elements are absent altogether, or present only in an unusual form, and that the principal requirement of a contract of service is the right of the master in some reasonable sense to control the method of doing the work, and that this factor of superintendence and control has frequently been treated as critical and decisive of the legal quality of the relationship.

Although more complicated tests have emerged to meet the more complex conditions of modern industry, the control factor retains its appeal to modern judges. In the past two decades the appeal courts in Ontario, Alberta and British Columbia have applied either Lord Thankerton's statements in *Short v. Henderson Limited*, or else a very similar wording of the control test.
However, other courts have had increasing difficulty with using the control of the work performed as the dominant factor. This judicial dissatisfaction has been caused by the increasing numbers of highly skilled and largely self-directed employees. Software programmers in the computer industry are typical examples. Such employees are normally assigned to a given project and the employer exercises a minimal amount of control and supervision.

The development of the information economy will accentuate this trend to non-hierarchial managerial styles. Many of the typical features of computer industry employment are the antithesis of the traditional control factors. The adoption of flex-time office hours, loosely defined organization structures, and project work assignments all reduce the employer's direct control. The widespread adoption of the electronic cottage or tele-commuting (working from a personal residence via electronic means) will result in even more detached control.

Thus, the courts have been increasingly uncomfortable with the control test's failure to recognize the changing reality of employment. As early as 1966 these reservations were expressed by Mocatta J. in Whittaker v. Minister of Pensions & National Ins.:

It seems clear, therefore, from the more recent cases that persons possessed of a high degree of professional skill and expertise, such as surgeons and civil engineers, may nevertheless be employed as servants under contracts of service, notwithstanding that their employers can, in the nature of things, exercise extremely little, if any, control over the way in which the skill is used. The test of control is, therefore, not as determinative as used to be thought to be the case, ...

In the 1976 case of Rosen v. The Queen the Federal Court of Canada was even more critical about the limitations of this test. Mr. Justice Marceau commented:
Superintendence and control cannot be the decisive test when one is dealing with professional man, or a man of some particular skill and experience. Instances of that have been given in the form of the master of a ship, an engine driver, a professional architect or, as in this case, a consulting engineer. In such cases there can be no question of the employer telling him how to do work; therefore, the absence of control and direction in that sense can be of little, if any, use as a test...27

Yet it can be argued that a court should not ignore the control factor, even for highly skilled and autonomous professions. The High Court of Australia has pointed to the potential right of control, rather than the actual exercise of the control. If the relationship is one of employment, then the ultimate control must rest with the employer. In Zuijs v. Wirth Brothers Proprietary Ltd., Dixon C.J. made the argument that:

The duties to be performed may depend so much on special skill of knowledge or they may be so clearly identified or the necessity of the employee acting on his own responsibility may be so evident, that little room for direction or command in detail may exist. But that is not the point. What matters is lawful authority to command so far as there is scope for it. And there must always be some room for it, if only in incidental or collateral matters.28

D. THE MULTIPLE TEST

As industrial society expanded after World War II, the courts moved away from the basic control test. Although an employer's apparent control over the employee was still a useful indicator, the list of other factors to be reviewed also increased. Lord Wright's judgment in Montreal v. Montreal Locomotive Works Ltd. signalled the major change. After noting that the more complex conditions of modern industry called for more complicated tests,29 Lord Wright outlined a series of elements to be considered in testing the existence of the employment relationship:
It has been suggested that a fourfold test would in some cases be more appropriate, a complex involving (1) control; (2) ownership of the tools; (3) chance of profit; (4) risk of loss. Control in itself is not always conclusive. In many cases the question can only be settled by examining the whole of the various elements which constitute the relationship between the parties. In this way it is in some cases possible to decide the issue by raising as the crucial question whose business is it, or, in other words, by asking whether the party is carrying on the business, in the sense of carrying it on for himself or on his own behalf and not merely for a superior.30

This open approach to the classification issue has been widely accepted in Canadian courts. The degree of flexibility in the use of multiple factors is shown by the Ontario Court of Appeal judgment in Re Telegram Publishing Co. Ltd. and Amn.31 In the original classification, the Referee had emphasized what he had termed the "organizational" test and the "economic dependency" test. The choice of names to describe the test(s) being applied by the referee did not deeply concern the Court of Appeal. The critical point on appeal was to determine whether the referee had properly considered all of the appropriate material elements in the relationship between the parties. Without discussing the two tests in any detail, Lacourciere, J.A. simply stated that such tests were acceptable in the context of the Montreal v. Montreal Locomotive judgment.32

The 1946 decision in Montreal v. Montreal Locomotive, opened the way for many other factors to be considered by Canadian and English courts. Power of selection and dismissal, payment of renumeration, exclusive service, place of work, hours of work, and the personal obligation to work have all become part of the expanded list.33

One difficulty with a test which uses multiple factors is the apparent lack of predictability. How can lawyers and their business clients predict the classification of a particular relationship?
Directing the court to consider a multitude of factors creates an enormous discretion for the court. The approach permits the court to arrive at a subjective view of the relationship.

However, continued concentration on the factor of control would not be any more effective. If the courts were to adopt one test to the exclusion of all others, then relationships would be organised so as to achieve the result desired by the dominant party. The alleged employment contracts would expressly exclude or include whatever factors were necessary. Many of the early British Columbia cases show that employers tried this tactic to circumvent the control test. In *Allison v. Standard Lumber Co.* the defendant argued that a contract of joint venture existed between himself and the plaintiff. In support, the defendant referred to a clause which set the plaintiff's compensation at "... a sum equivalent to twenty-five percent of the net profits as computed semi-annually." The B.C. Court of Appeal looked to other factors, such as exclusive service and control to find that an employment relationship existed.\(^{34}\) In *Donkin v. Disher* the Supreme Court of Canada was faced with the argument that a partnership had been established between the parties. The supporting evidence was a new agreement allotting a percentage of profits in lieu of a salary, and correspondence referring to a partnership. Yet this evidence was not decisive, and an employment situation was found to exist.\(^{35}\)

The strength of the multiple factor test approach comes in allowing the court to reject any particular factors that are inconsistent with the true relationship between the parties.
E. THE ORGANIZATION OR INTEGRATION TEST

As with other developing areas of the law, Lord Denning has had an influence on employment relationships. In proposing the integration test, Lord Denning recognized the increasing independence of employees with special skills. Highly trained specialists are not controlled in the traditional sense by employers. Therefore this test suggests that the court should look at the degree to which the specialist is integrated into the business organization.

The case of *Stephenson, Jordan and Harrison Ltd. v. MacDonald and Evans* provided the initial formulation of this approach:

Under a contract of service, a man is employed as part of the business and his work is done as an integral part of the business; whereas under a contract for services his work, although done for the business, is not integrated into it but is only accessory to it. 36

A data processing manager in a large corporation is an example of a skilled employee who would be covered by this test. Although most corporate executives lack the expertise to closely supervise or control a data processing manager, his activities are a key part of the corporate business. The functions of data processing are necessarily tied to the daily operation of every corporate department.

The clear advantage of this test is the attention paid to the substance of the relationship. By taking a wide perspective, the court is able to assess the actual significance of the relationship to the parties involved. Thus, in *Rosen v. The Queen*, the Federal Court of Canada was able to properly deal with an apparent lack of control by the employer.

The work done by the plaintiff for the three schools at which he taught was done as an integral part of the curricula of the schools; the courses were regular courses and, if I may say so, the business in which he was actively participating was the business of the schools not his own. 37
Yet this test has inherent limitations. Not every highly skilled individual is going to be integrated into the organization. The business may decide to engage systems analysts and programmers to develop a new data processing application. In this situation the individuals are performing a function that is ancillary to normal operations. Thus the individuals will not be integrated in the organization, but still may qualify as employees in all other respects. Functions such as research, advertising, insurance and safety are examples of departments that may be ancillary to the principal activity of a business organization. Accordingly, few current decisions have chosen to rely exclusively on the integration test.

The 1979 decision of the Ontario Court of Appeal in *Mayer v. Conrad Lavigne Ltd.* reflects this caution. The unanimous decision referred to both the multiple test of Lord Wright in *Montreal Locomotive*, and to the organization test expounded by Lord Denning. The conclusion was that the facts satisfied whatever test was used. The work in question "was clearly integrated into the business and not merely accessory to it."38 As the *Mayer* decision and other cases illustrate, the integration test functions best as a backstop or safety net to the multiple test.39

F. SUMMARY

After examining the three distinct tests for the employment relationship, several conclusions are apparent. Present case law does not compel the courts to apply a rigid framework for classifying an individual as an employee rather than an agent or independent contractor. Instead, the courts are given a wide ranging discretion in the choice of legal tests. This flexibility extends even further into the interpretation of the facts.
One over-riding objective seems to lie behind this deliberate flexibility. The judiciary consistently recognizes the need to interpret employment contracts in light of their particular circumstances. The mutual intent of the parties, their conduct after entering the relationship, and the surrounding commercial environment all must be examined. At the same time, the courts may ignore any specific terms of the contract that conflict with the real situation. With this broad discretion, the courts are able to make determinations of legal status that are based on the reality of the relationship.

Another advantage to these broad interpretative powers lies in the response to change. This is not an area of the common law which has been trapped in out-dated doctrines. Once the limitations of the control test were obvious, the judges moved relatively quickly to the two distinct alternatives. In this way the law has kept pace with business practices and shifts in the economy. Such agility will be even more important as the courts are confronted with an information economy. Skilled employees in the computer industry are even more independent, more mobile, and more sophisticated than industrial workers. The dividing line between managers and workers will be even more blurred, and there will be an increasing variety of work arrangements.

The dangers associated with the courts' broad discretionary power appear to be limited. The biggest social risk lies with a judiciary that loses its awareness of external social changes. Such a blind spot could lead to inappropriate classifications, and economic inefficiencies. Yet the past record of the courts seems to minimize this risk. The intense examination that the courts give to the circumstances of each case keeps the judges well informed of the current business trends. In conclusion,
the common law is well-equipped to decide whether a particular individual is an employee.
FOOTNOTES: CHAPTER III

1. H. Menzies, Computers on the Job, (1982) James Lorimer and Co. Toronto; Science Council of Canada, Planning Now for an Information Society: Tomorrow is Too Late (1982/83) Report No.33; For a measure of the increasing significance of computers in Canada see Canadian Information Processing Society (C.I.P.S.) 1984 Canadian Computer Census at page 20 which indicates that in May 1979 there were 8598 computer installations in Canada (not including computers that rent for less than $1,000.00 per month). In December 1983 the number of installations had increased to 16643.

2. Id.

3. Chapter IV examines the Fiduciary and Implied Obligations of an Employee.

4. Id.

5. Partnership Act, R.S.B.C. 1979, c. 312, s. 2(1) defining partnership.

6. Id. at s. 11 and 12.

7. Chapter V provides a detailed examination of the doctrine of restraint of trade, and Chapter VII summarizes the conclusions of the thesis.

8. Id. at p. 118.

9. Id. at p. 126-29.

10. Id. at p. 129-30.


18. Id., at 756 W.W.R.


22. (1946), 115 L.J.P.C. 42, at 47

23. Id., note 15.


27. Id., at 465-66 (C.T.C.); at 383-84 (D.L.R.).


29. **Supra**, note 18, at 756.
30. Supra, note 18, at 756-757.

31. Supra, note 20.

32. Supra, note 20, at 461.


34. [1924] 3 W.W.R. 481, 34 B.C.R. 257.

35. (1913) 49 S.C.R. 60, 16 D.L.R. 610.


40. Supra, note 20.
III EMPLOYER'S PROPRIETARY RIGHTS TO INFORMATION:

A. GENERAL CONSIDERATIONS

We are witnessing a technological revolution that is reshaping our world, calling for new, innovative responses from people. Daily, technology is creating new opportunities for the human mind to expand into areas only dreamed of a few short years ago. Increasingly, those countries that can draw forth their innovative talent are those that will prosper.¹

The preceding two chapters provided background material for the central theme of this thesis. Chapter I introduced the concept of an information based economy, and then reviewed the information-as-property paradigm currently being used by lawyers and legislators. The chapter concluded that these policy tensions will only increase as our society places an increasingly greater value on information as an economic resource.² Chapter II then examined the legal tests that determine whether an employment relationship exists between two parties. The legal status of employee must be distinguished from the other categories such as independent contractor or agent because of the different legal obligation that attach to each group.³

This third chapter concentrates on an employer's proprietary rights to information. As discussed Chapter I, one example of high technology information has been selected to illustrate the application of legal principles. Software and its creation, distribution and marketing will be the reference product.

The intent of this chapter is to examine the proprietary basis that underlies an employer's demands for legal protection against a former employee. What are the legal grounds upon which an employer claims the right to restrict an ex-employee's activities? What interest is a court
protecting by enforcing obligations of secrecy or confidentiality against a skilled employee in the computer industry? This chapter will review an employer's rights to software under the patent and copyright legislation, and then focus on the theory of trade secrets and breach of confidence. Later, in Chapter V, the balance between an employer's proprietary interests and the employee's rights to compete will be analyzed in light of the specific requirements of the doctrine of restraint of trade. There are degrees of protection for an employer offered by the field of criminal law, but space does not permit a complete discussion of all of the recent developments in this area.

It would be incorrect to discuss an employer's proprietary rights to software or any other information based product in a narrow perspective. An employer's rights must always be viewed as competing with both the interests of employees and the society at large. The law has always had to execute a delicate balancing act in this area. English and Canadian case law has always tried to reconcile the contradictory demands of the employer and the employee, while simultaneously preserving and protecting the public interest.

The objectives of the common law on employment were well summarized in the 1960 American decision of \textit{Wexler v. Greenberg}. The following quotation presents certain themes that have reoccurred in Canadian and American courts. Judges have long been concerned with employer's proprietary rights, as well as the employee's right of mobility and choice of livelihood, and the interest of society in open competition and the encouragement of innovation.

\textit{Society as a whole greatly benefits from technological improvements. Without some means of post-employment protection to assure that valuable}
developments or improvements are exclusively those of the employer, the businessman could not afford to subsidize research or improve current methods. In addition, it must be recognized that modern economic growth and development have pushed the business venture beyond the size of the one man firm, forcing the businessman to a much greater degree to entrust confidential business information relating to technological development to appropriate employees. While recognizing the utility in the dispersion of responsibilities in larger firms, the optimum amount of 'entrusting' will not occur unless the risk of loss to the businessman through a breach of trust can be held to a minimum.

On the other hand, any form of post employment restraint reduces the economic mobility of employees and limits their personal freedom to pursue a preferred course of livelihood. The employee's bargaining position is weakened because he is potentially shackled by the acquisition of alleged trade secrets; and thus paradoxically, he is restrained, because of his increased expertise, from advancing further in the industry in which he is most productive. Moreover, as previously mentioned, society suffers because competition is diminished by slackening the dissemination of ideas, processes and methods.  

Any legal system in a technologically advanced nation faces the task of reconciling these competing policy concerns with respect to employers and employees. As early as 1602 the English courts faced the issue of an employee's right to mobility and to choose a livelihood. In the case of Colgate v. Bacheler, the English courts displayed the initial objections to contractual limitations on the rights of an individual to engage in a lawful trade. Although there have been modifications of the legal principles throughout the centuries, Canadian courts today apply the doctrine of restraint of trade to balance the rival interests of the employers, and the employees.

At the same time, Canadian courts also recognize that a strong public interest surrounds the employment relationship. There has been a constant
legislative and judicial rejection of actions in the marketplace that limit or prevent competition. The Supreme Court of Canada has endorsed the competitive ideal in vigorous language. In reference to the Combines Investigation Act, Taschereau J. stated that "The public is entitled to the benefits of free competition, and the prohibitions of the Act cannot be evaded by good motives." In the same decision, Kellock J. summarized the basic policy underlying the Act. "The statute proceeds upon the footing that the preventing or lessening of competition is in itself an injury to the public. It is not concerned with public injury or public benefit from any other standpoint." 

Canadian courts have similarly spoken out on the importance of competition in the employment relationship. In T.S. Taylor Machinery Co. Ltd. v. Biggar, the Manitoba Court of Appeal reviewed a restrictive employment covenant and then asked:

Why would the courts not recognize his freedom to contract and give effect to a restraint imposed upon him by his own agreement? The answer lies in the fact that there is another freedom which must be considered, the freedom of a man to carry on his lawful trade or profession without hindrance, to the benefit of himself and his family and the community at large. To the extent that restraints are placed upon a man's right to earn his living and to make the best use of his skills, the country at large suffers."

Finally, the Canadian political system has long provided incentives for creation and innovation. The obvious illustration of this policy lies in patent and copyright legislation. Canadian inventors and authors are rewarded and encouraged by the grant of a statutory monopoly on qualifying works. Under the Copyright Act and the Patent Act, the patent or copyright holder receives the statutory protection that permits an
inventor to exploit his invention, or an author to guard his creation against unauthorized copying.  

How then do these basic policies of freedom for employees, maintenance of competition, and encouragement of innovation apply to the information economy? Is the existing accommodation between the competing demands going to be adequate in the information age? Or is the current balance between the interests of employers, employees and the public rapidly being tilted to precarious extremes?

The pivotal point of the existing common law is the doctrine of restraint of trade. This doctrine allocates rights between employer and employee by testing the reasonableness of the restrictive covenants given by the employee/covenantor. In effect, promises of non-competition or non-disclosure by the employee will only be enforced if the restraints are reasonably necessary to protect the proprietary interests of the employer.  

It is suggested that the information economy is creating unanticipated imbalances in the delicate weighting of the employment relationship. The Wexler decision aptly described the tensions between employers, employees and the public that were apparent in 1960. However, in 1985, these same tensions are affected by new realities in the computer industry. It is suggested that courts and legislators must be aware of the dimensions of the following factors:

(1) an increasing commercial reliance on secrecy and confidentiality;

(2) the confusion over ownership of software;

(3) possible policy biases in the existing law; and
(4) the policy objections to property rights in information.
Each of these concerns will be briefly explored.

(1) Increasing Commercial Reliance on Secrecy and Confidentiality:

Why does the widespread use of software lead to increased commercial concern with confidentiality? The successful development of software does not depend upon the employer simply achieving a "dispersion of responsibilities..." to employees as suggested in the Wexler decision. In 1960, the Wexler court was discussing trade secrets that were only secondarily used to produce the primary products of an industrial firm. Today, a software firm is in the business of producing and selling trade secrets. Aside from the mass distributed packages for personal computers, most commercial software is marketed under restrictive licensing arrangements that impose strict obligations of confidentiality on the licensee. As a result, even the employer that simply uses software as an authorized licensee must now be concerned about trusting his employees.

Aside from the confidentiality problem in distribution, there are special problems in the development of software. Only rarely is software created by a single employee working alone under a well defined contract of employment. Usually the idea for a new software package comes either from an internal group of employees, or is an update or improvement of a package already offered by a competitor. Even after the initial specification stage, the writing of the source code and testing of the program will likely be a group effort. The logical reason for this approach is that well organized group work spurs creativity and avoids costly mistakes. However, this type of group effort to produce a trade
secret directly conflicts with legal efforts to establish a clear claim to confidentiality.

(2) Confusion Over Ownership of Software

The widespread use of information such as software has heightened concerns over the ownership issue. The large number of individuals who are potentially involved in software development means that there can be many competing claims to ownership. Who holds the legal rights to license the software and to receive the user fees? How does the "employer" developer avoid lawsuits from outside licensors of similar programs or from disgruntled employees? Although these questions do not have easy legal answers, there are many interested groups who require a definite response.

Specifically, the marketing staff at all points in the distribution chain must be able to reassure customers about the ownership issue. Licensees of software do not wish to be third parties in injunction actions taken by other claimants to software ownership. Marketeers must also worry about the reputation of the product, and the resulting loss of sales if either a competitor or a former employee puts forth a conflicting claim on ownership.

Financing the development of software also requires certainty about ownership and the associated legal rights. Now that high technology has been recognized in financial circles, there are many investors willing to risk their money in the information sector. The past three years have seen the use of research and development limited partnerships, flow-through common shares in a corporation to pass on research tax credits to investors, and most recently a preferred share issue to take advantage
of the Federal government's Special Recovery Refundable Investment tax credit. However, whatever route is selected to attract investors, the viability of the investment always rests on ascertainable legal rights. The lawyer who prepares the financing prospectus must be able to render a legal opinion on the assets being acquired.

Finally, the licensee users of software have definite interests in the ownership question. Initially, the licensees want to be assured that they are receiving a valid license and will not be party to an infringement action. In fact, most sophisticated users request that the licensor provide them with a contractual indemnity against this type of legal liability. More importantly, licensees are concerned that they receive well-defined rights for software maintenance, and that they are protected in the event that the licensor goes out of business or becomes bankrupt.

(3) Possible Policy Biases in the Existing Law

Are there biases in the common law governing the employment relationship that conflict with the unique attributes of information such as software? This portion of the discussion will consider this question in light of the basic policy considerations noted in the Wexler decision. First, it should be noted that the groups discussed in the preceding paragraphs all had interests in common with the employer. The developers, the marketeers, the financiers, and the users all expect the law to define a bundle of property rights to secure and protect their interests. But the law must also consider the rights of employees and the public interest in encouraging competition and innovation. How then will the basic policies be affected by information employment?
The doctrine of restraint of trade illustrates two possible biases in favour of the common law employee. First, the existing case law recognizes a qualitative difference between restrictive covenants granted by the vendor of a business as compared to restrictive covenants that are granted by an employee. Trial courts have been directed to apply a far more rigid construction to employment covenants. The higher standard of proof for the employer has been viewed as the proper way to adjust for the employer's advantage in bargaining.

Does the information employer still have this same advantage in the formation of the employment contract? Arguments can now be made that the information employee actually enjoys a practical negotiating advantage over his employer. This apparent shift in the balance of power relates both to the characteristics of information and to the speed of technological change.

Qualified information employees such as programmers or top level electrical engineers are in short supply, and frequently change jobs in response to the offers of competitors. At the same time, it is very difficult for an employer to detect or to prevent loss of software. Information such as software can be easily and inexpensively duplicated, and there is no physical evidence left behind to alert the employer. In addition, there is a considerable personal incentive for the employee to appropriate software. Creating software is notably labour intensive. A departing programmer might understandably feel that he is entitled to have at least one copy of his labours. The unsettled nature of most information related sectors also means that no clear code of ethics has yet developed for information employees.
Finally, there is the obvious financial incentive behind the appropriation and use of software for personal gain. There are not many barriers to entry in the software industry and almost a total absence of regulatory controls. A departing employee finds it relatively easy to establish a new business that directly competes with his former employer.

In a recent article for the Practising Law Institute, Daniel T. Brooks discussed the legal concerns of the major participants in the American software industry. According to the surveys cited, there was a surprising lack of concern among many groups about the adequacy of statutory monopolies to protect software. For a variety of reasons, service bureaus, small corporate users, government, universities and the mass marketeers all thought that external statutory protection was a low priority.\(^21\)

Brooks then noted the threat of software piracy, and concluded that employees posed the greatest risk for the firms involved. He compared the factors contributing to software piracy by home users, by industrial users (corporations and employees), and by organized pirates. Although all the other groups were viewed as manageable problems, piracy by employees earned the description of a "very troublesome problem."\(^22\)

One possible conclusion is that the existing case law wrongly assumes that the employer holds the balance of bargaining strength in all employment relationships. There are strong arguments that information employment should be viewed as a relationship between equals, with no special bias for the employee.

A second inappropriate bias in the existing law on restraint of trade has been highlighted by the Law Reform Commission of British Columbia. In
its 1984 Report on Covenants in Restraint of Trade\textsuperscript{22a} the Commission noted that courts have traditionally ruled that a restrictive covenant that fails to meet the test of reasonableness must be wholly unenforceable. After examining "[M]odern business practice, the increased complexity of modern society, and the changing judicial perception of the relevant factors...\textsuperscript{22b}, the Commission recommended new legislation to allow partial enforceability of restrictive covenants. The reform was put forth to "strike a fairer balance between covenantor and convenantee".\textsuperscript{22c}

This discussion has outlined two biases in the existing law that work in favor of the employee/covenantor. It is suggested that the original justifications for the biases are no longer valid for the skilled employee in the computer industry.

(4) Policy Objections to Property Rights in Information

A final consideration must be the "property" orientation of existing law. This was referred to as a legal paradigm in the introductory chapter. Hammond rejects the present strong faith in property concepts as being inappropriate and wasteful for the efficient use of information. In Hammond's view, trade secret laws wrongly encourage the holders to think of the information as their "property", instead of a valuable social resource.

There are also sound economic reasons to support this policy (of promoting wide-spread use of information): research and information generation is expensive; duplication of effort is wasteful; excessive secrecy promotes espionage, and serious diversion of effort occurs every day in industry to find out what competitors are doing.

It is a measure of the present failure of western legal systems that industrial innovators are increasingly avoiding the very systems set up to
promote disclosure. Consensual agreements and trade-secret protection are now the paradigmatic way of dealing with information, research and development output.23

The arguments that Hammond uses to support his non-property stance are not well recognized either in Canadian caselaw or in the legal literature. However, the specific arguments are provocative and worth noting. Eight separate points are advanced against classifying information in the strict concept of property.

1) The concept of sole ownership is inappropriate for information.

2) Certain types of information can be infinitely multiplied at low cost.

3) Information generally does not depreciate with use.

4) Unused information is generally of no value. But if information is used too much, it can enter the public domain and again have no value.

5) Creation of information is usually a joint activity; division of ownership is extraordinarily difficult.

6) The longer frequency statutory monopolies are out of phase with the shorter frequency for information innovation.

7) Volume of information has reached over-whelming proportions, yet classical economics assumes complete information about property in the market.

8) Information cannot be reasonably separated into private goods and public goods.24

In contrast to Hammond's arguments, the limited discussion of information in Canadian law reports or in current legal literature displays a strong property orientation. For example, an English writer recently proposed that the solution to the commercial exploitation of information was to develop an expanded definition of property that was
appropriate to modern conditions. Another recent article in the Queens Law Journal dealt with the use of restrictive covenants in the employment contract. The author commented on the 1979 Ontario High Court decision in Schauenburg Industries v. Borowski. The case involved a former employee who used confidential information to compete with his former employer. Although the author approved of the courts decision to restrain the employee, readers were cautioned not to ignore the "property" basis for the decision:

One should be careful not to take the rationale of Schauenburg v.Borowski too far. It is submitted that while information not totally secret may be entitled to protection if its circulation is very limited, nevertheless, there must be a substantial degree of secrecy in order to brand the information with the exclusivity which is a characteristic of property rights and which will give the reasonable employee notice that the information is his employer's and not merely public property.

With a similar property orientation, numerous American articles present arguments for extending the statutory monopolies (ie: patent and copyright) to protect software. The line of reasoning is that unless the creations (ie; property) of programmers and developers are protected then there are disincentives to create computer works. Lack of protection for these works inhibits the advance of technology and science, and ultimately affects the national and public interest. Accordingly, the public good is best served by the recognition of private property interests. As Brooks points out, most large software house and user corporations want property protection to prevent the same type of unauthorized duplication of software.

In summary, this discussion illustrates that the creation of new types of information, such as software, is also creating new policy concerns for the common law that governs the employment relationship.
B. PATENT PROTECTION FOR INFORMATION

The common law system in Canada is just beginning to encounter the first legal cases that are emerging from the widespread introduction of computer technology. As a result of the widespread use of microprocessors, the legal system is starting to re-examine existing principles of law. One particular concern is whether present statutory protection can be properly applied to the protection of electronic information such as computer software.

In an information economy, the major advances are measured by gains in the generations of technology used to process, store and distribute data information material. However, each apparent advance in the physical and technical hardware only camouflages the real creative innovation. The true leap forward that must have already occurred is in the design of the system software and application software. Even for the purchaser of a personal computer, the supporting application software usually ranks as a key factor in evaluating the competing models. Thus, the real concern for major vendors such as I.B.M. is to protect the ideas and information behind the physical product. The critical legal focus must be on the security of software rather than on the protection of hardware.

In Canada, the legislation that possibly could be used for the protection of software is limited. Neither the Patent Act nor the Copyright Act has been significantly amended since the 1920s. As a result, neither statute specifically recognizes any of the new technologies such as videotape, satellite communications, cable broadcasting or computer software. In some situations the basic concepts in the legislation have been effectively applied to deal with more recent
But the following discussion will show that the attempt to stretch the existing patent legislation to cover computer software has been unsuccessful. Thus, the difficulties with using patent law for the protection of information are well illustrated by reviewing the software situation.

Before the software position is reviewed, the general concepts of patent legislation will be identified. In theory, patents are granted "as a reward for inventors who publish their inventions in return for a monopoly right to the exploitation of their inventions over a period of years." During the limited term of the patent monopoly, the statute permits the patent holder to use infringement actions to protect his invention against unauthorized use.

No protection exists for an invention under the legislation until after an application is made to the Canada Patent Office and the patent granted. The grant of a patent is limited as to time (17 years) and to the subject matter of the specific invention. A patent holder has the legal right to prevent unauthorized use of the subject matter in Canada. Also, the inventor named in the application must be the original inventor of the proposed subject matter. This latter requirement can cause serious problems in obtaining a patent for an invention made by a group of individuals (i.e.: a software development group), or by an individual employee who refuses to apply for the patent.

Can computer software be patented under the Patent Act? The following two sections of the legislation are relevant:

Section 2
Invention means "... any new and useful art, process, machine, manufacture or composition of matter, or any
new and useful improvement in any art, process, machine, manufacture or composition of matter;"

Section 28(B)
"No patent shall issue for an invention that has an illicit object in view, or for any mere scientific principle or abstract theorem." (underlining added)

As stated in 2 above, the invention must be new or useful as compared to the current state of the technology. Thus, there is a requirement for a degree of novelty or uniqueness in the subject matter of the invention.

Can software be patented as a computer-related invention under the Patent Act? The judgement of the Federal Court of Appeal in Schlumberger Canada Ltd. v. Commissioner of Patents appears to represent the current law in Canada. Leave to appeal from this decision to the Supreme Court of Canada was refused.

In a short three page decision, Pratte J. noted that in substance the Schlumberger program directed a computer to perform mechanically a series of mathematical calculations. The observation was then made that the same calculations could be performed mentally by humans. Simply using a computer to perform the calculations did not constitute a "new or useful" advance in the technology. In the words of Pratte J.:

... the fact that a computer is or should be used to implement discovery does not change the nature of that discovery. What the appellant claims as an invention here is merely the discovery that by making certain calculations according to certain formulae, useful information could be extracted from certain measurements. This is not, in my view, an invention within the meaning of s.2. Accordingly the appeal was dismissed on the grounds that no invention within the meaning of section 2 had been established.

The Canadian Patent Office views the Schlumberger case as confirming the following rule:
"A computer program per se, an algorithm, or a set of instructions to operate a computer (which is essentially mathematical information developed from an algorithm) is not patentable."

The original decision of the Patent Appeal Branch in the Schlumberger case provides a more extensive set of guidelines for any future applications.

(a) Claims to a computer per se are not patentable;

(b) Claims to a new method of operating a computer are not patentable;

(c) Claims to a computer programmed in a novel manner, expressed in any and all modes, where the novelty lies solely in the program or algorithm, are not directed to patentable subject matter under Section 2 of the Patent Act;

(d) Claims to a computing apparatus programmed in a novel manner, where the patentable advance is in the apparatus itself, are patentable; and

(e) Claims to a method or process carried out with a specific novel apparatus devised to implement a newly discovered idea are patentable.

Thus, the software example shows that patent legislation provides protection for novel advances in the physical technology, but resists any attempt to stake a monopoly on the underlying idea for the invention. In fact, the Schlumberger decision points out a basic legal reality: the concept of a patent was never intended to provide protection for the creation of new information.

C. COPYRIGHT PROTECTION

This section analyses Canadian copyright legislation as it applies to electronic information and again will be using software as the principal illustration.
In brief fashion the analysis will move through the operation of the Copyright Act, and then to the question of whether copyright properly applies to software. Finally, the American experience with copyright protection for software will be discussed.

The key features of the Canadian copyright legislation are as follows. The copyright system is designed to protect the expression of an idea. The idea itself cannot be the subject of copyright, only the particular way in which that idea is expressed. Colin Tapper presents this view of copyright legislation by stating:

The basic protection afforded by copyright is directed against reproduction of the form of the original material. The idea upon which the original is based is not protected as such, nor is any protection afforded against any use of the copyright material which does not itself involve copying. Independent creation and the exploitation of identical, but uncopied, material is also unaffected. It is difficult to specify precisely and in advance just where the distinction between an idea and its form of expression will be drawn by a court.

Another feature is that copyright in Canada does not have to be registered with the Copyright Registry to be legally enforceable. Copyright exists as soon as any literary, artistic, musical or dramatic work is created. Even though registration is not mandatory, there are some advantages provided by the act of registration. Registration acts as constructive notice of copyright to all potential infringers. This avoids the defence that the infringer was unaware of the copyright. The statute also provides a lengthy time for copyright protection. Minimum period is fifty years, or the life of the author plus fifty years from the author's death.

Also, registration establishes certain presumptions that are useful if a court action to prevent infringement is taken. For example, the
registration establishes a definite date for the creation of the copyright. One last feature of our Canadian system is that an applicant for copyright registration does not have to prove originality (authorship) at the time of registration. A copy of the work to be registered does not even have to be filed at the time of registration.

Can computer software be protected by copyright in Canada? We must first ask whether a software program can be defined as an "artistic work" or "literary work" and therefore be eligible for protection.

Section 3.(1) defines copyright as follows:

For the purposes of this Act, "copyright" means the sole right to produce or reproduce the work or any substantial part thereof in any material form whatever, to perform, or in the case of a lecture to deliver, the work or any substantial part thereof in public; if the work is unpublished, to publish the work or any substantial part thereof; and includes the sole right

(a) to produce, reproduce, perform, or publish any translation of the work;
(b) in the case of a dramatic work, to convert it into a novel or other non-dramatic work;
(c) in the case of a literary, dramatic or musical work, to make any record, perforated roll, cinematograph film; or other contrivance by means of which the work may be mechanically performed or delivered.

Section 2. of the Act provides the following definitions:

"Artistic work" includes work of painting, drawing, sculpture, and artistic craftsmanship, and architectural works of art and engravings and photographs;

"Literary work" includes maps, charts, plans, tables, and compilations.

This statute came into force in 1924 and has been substantially unamended since that date. As a result, the legislation does not expressly recognize any of the technologies that have been developed since 1924.
Therefore, in order to apply copyright protection to software, the copyright must be argued by analogy to much older generations of technology.

However, using the literal application of the statute, copyright logically covers all written documentation involved in the creation of electronic information. English and Canadian lawyers have therefore concluded that program descriptions, flow charts, and user manuals can be described as literary works and therefore protected by copyright. 44

The major difficulty with copyright protection arises with the distinction between source code and object code. 45 Since source code is meant to be read by human programmers, and can be expressed in a physical form that is comparable to an alleged copy, a strong claim can be made that source code is covered by the statute. Another argument in support of protection for source code is the right of translation. Copyright not only extends to the original work, but also to the right "to produce, reproduce, perform or publish any translation of the work;". 46 Therefore, it can be argued that writing the source code in FORTRAN or COBOL as an object program is simply a translation of the original work into a programming language.

It is much more difficult to argue that an object code program by itself is covered by the Copyright Act. First, an object program is designed to be machine readable, and is not intended to be read by a human being. Object code is normally expressed in the form of electrical impulses on magnetic tape. A claim for copyright protection of object code therefore challenges a basic premise of the legislation. Given that the copyright was designed to secure the expression of an idea, 47 then it
must be assumed that the expression must be intelligible to humans. To grant copyright to machine communications would be contrary to the intent of the act. Two dissenting commissioners to the CONTU report in the United States opposed the American extension of copyright protection for software on this basis. They stated the philosophical conflict over the status of object code as follows:

[A] society that accepts in any degree such equivalences of human beings and machines must become impoverished in the long run in those aspects on the human spirit which can never be fully quantified and which machines .... will never be able to experience, never be able to bring to life, never be able therefore to communicate.

Another problem exists under the Canadian legislation for the protection of object code. There is a general requirement that a work under the Copyright Act be expressed in a material form. In effect, the material form requirement anticipates that a court be able to observe the distinguishing characteristics of the original work and any copy thereof. In a literal sense, the test for a copyright infringement is the comparison of the original with the alleged infringing copy. Object code for a software program lacks the required material form that provides identifying characteristics that are apparent to the human senses. A floppy disk containing a software program is humanly indistinguishable from a blank disk. Only the computer can tell the difference between the two disks. Therefore, until object code is translated into some medium of hard copy, an arguable conclusion is that it can neither be copyrighted nor infringed.

There is a basic technological capability that further undermines the source code versus object code distinction. Although source code might
initially be expressed in the form of hard copy documentation, and object code normally be expressed in electrical impulses on a floppy disk, both types of codes are increasingly being expressed in the entire range of tangible to intangible formats. Therefore, the issue of copyright protection must be tested not only by the type of code, but also with respect to the particular form of expression that was being used at the time of the alleged act of infringement.

Prior to 1983, Canadian courts had not dealt directly nor decisively with the question of software copyright. There has also been very little legislative activity to deal with the question. Although there are persistent rumors of amendments to the Copyright Act to specifically cover software, the House of Commons has not yet approved any changes. In 1984, the Federal government released its white paper on copyright entitled "From Gutenberg to Telidon." The paper proposes revisions to the Copyright Act to provide intellectual property protection for computer programs. However, it is doubtful that these proposals will be implemented in the next two to three years.

However, during the past twenty-four months a number of interlocutory applications in Ontario and Quebec have started to test the issue of software copyright. In Apple Computer Inc. v. Computermat Inc., Software One Ltd. and Michael Stanford, the plaintiff was seeking an interlocutory injunction to prevent infringement of its alleged copyright in software on floppy disks and on chips. After noting that there were no applicable Canadian trial decisions, Mr. Justice Hughes referred to the interlocutory decision of the Federal Court of Appeal in Nintendo of America Inc. v. Coinex Video Games Inc., 1982. In the Nintendo case,
interlocutory relief had been granted to protect software which had been permanently wired on a chip (normally called firmware\textsuperscript{57}). In effect, firmware is a technical hybrid that occupies a middle ground between hardware and software.

In the Apple case, Mr. Justice Hughes refused to grant the injunction request, but still recognized the seriousness of the plaintiff's claim to copyright. The interlocutory order provided that if the defendant wished to continue selling the software, it was required to post a $100,000.00 bond to secure the plaintiff's potential recovery of damages at trial. It is perhaps significant that the other corporate defendant, Software One Ltd., did not even contest the injunction application against its software sales.\textsuperscript{58}

In a second interlocutory proceeding, \textit{Space File Limited. v. Smart Computing System},\textsuperscript{59} Mr. Justice Steele dealt more directly with the software issue.\textsuperscript{60} Although the decision is as yet unreported, Mr. Justice Steele apparently was willing to admit that the plaintiff's documentation manual, source code program, and object code program were all protected by copyright. The Court reportedly stated that:

\begin{quote}
The manual is in printed form. The source code and the programs are electronically recorded on disks but are capable of, and have been, printed from them. They are original ideas expressed in a particular form. They are the proper subject of copyright.\textsuperscript{61}
\end{quote}

The most optimistic interlocutory decision is that of Reed J. in \textit{I.B.M. v. Spirales Computers Inc.},\textsuperscript{62}, which granted an injunction restraining the defendants from infringing the plaintiff's apparent copyright in a BIOS software program. The BIOS system is part of the I.B.M. P.C. (personal computer) and is permanently affixed on a chip in
the computer's read only memory (ROM). Although the plaintiff had received a copyright registration certificate for both the source code and object code listings as expressed in its Technical Reference Manual, the alleged act of infringement was the physical duplication of the firmware/chip.

Thus, the I.B.M. v. Spirales interlocutory decision can be interpreted as extending copyright protection to object code even when the code is physically burned into a silicon chip and only employed for machine communication.

It is suggested that the I.B.M. v. Spirales judgement is not well reasoned. The decision fails to distinguish between the various media in which software can be expressed, and rather loosely refers to a number of software copyright decisions from other jurisdictions. This criticism appears to be confirmed by the recent refusal of another Federal Court judge to grant an interlocutory injunction to Apple Canada Inc. On January 17, 1985, Mr. Justice Cullen agreed that the defendants had an arguable case on all of the issues covering an Apple Canada Inc. claim to copyright protection for its Autostart read-only memory (ROM) chip. However, the arguments were not convincing enough to secure the interlocutory injunction order.

In summary, the protection of copyright marginally secures a creator's rights to electronic information. As the software example shows, a reasonable conclusion is that the supporting written documentation for this type of information is protected by copyright. But copyright for the electronic versions of a software program is far less certain, and especially in the absence of any trial court decisions. Tapper reaches a similar conclusion with regard to the United Kingdom's
copyright legislation. Since the legislation contains "no explicit references to computer programs, and as its application to them has not so far been tested in the courts any final judgment upon the matter must remain speculative." 64

The Copyright Act does provide one other source of protection for an information employer. Although the original author normally holds the copyright, Section 12 (3) reverses this presumption in the context of the employment relationship.

Where the author was in the employment of some other person under a contract of service or apprenticeship and the work was made in the course of his employment by that person, the person by whom the author was employed shall, in the absence of any other agreement to the contrary, be the first owner of the copyright.64a

As discussed in the previous chapter, the section 12(3) prescription can be an important commercial impetus for distinguishing between independent contractors and employees.64b In Silverson v. Neon Products Ltd., the B.C. Supreme Court relied, in part, upon sec 12(3) to dismiss a copyright infringement action brought by an ex-employee.64c

The Computer Software Copyright Act of 1980 65 in the United States provides certain lessons for any attempt to protect information via copyright legislation. The United States has now had more than three years of experience with statutory protection for software. The effectiveness of the 1980 amendments were recently considered in the Computer/Law Journal.66 Mihm reviewed the double threat of software piracy from competitors who copy and resell and from individuals who copy for personal use. His conclusion was that protecting computer software via copyright was "neither effective nor practical" to deal with either of
these threats. The explanation was that "The process of detecting copyright infringement and then proving it and obtaining a recovery is too difficult and uncertain to be of great value." If Mihm's conclusions are correct, then amendments to the Canadian act may not provide final nor effective protection for electronic information.

In one other area, Canadian copyright law appears to avoid one of the conflicts experienced in the United States. For a number of years it was feared that registering for Federal copyright protection in the U.S.A. would extinguish or pre-empt trade secret protection. This widespread concern among American software producers was caused by the requirement of disclosure under the U.S. copyright legislation. As noted previously, a copyright holder in Canada is not required to disclose his original material at the time of copyright registration. This point is critical to prevent the waiver of trade secret protection. While specific legal principles will be reviewed in the next section, the general rule is that publication of a trade secret ends the legal protection provided to the user. If the holder of the secret has released the information to the public, then the holder cannot claim continued protection for the secret.

Following this logic, the critical legal question then is whether the registration of a copyright amounted to the publication of the information to the public? In the United States the possibility that copyright registration might pre-empt trade secret protection plagued the software industry for almost a decade. Finally, the U.S. Supreme Court ruled that Congress did not intend to pre-empt state trade secret law with the federal Copyright Act.

Fortunately, this pre-emption issue can be avoided in Canada so long as the subject matter of the copyright is not filed with the copyright
application. Also, the Canadian statute does not require materials to be marked with the identifying copyright and the date of first publication. Under American law the requirement of marking the publication date on the materials unavoidably raised the pre-emption conflict. Finally, although copyright is strictly a statutory right, section 45 of the Act qualifies copyright by stating that "nothing in this section shall be construed as abrogating any right of jurisdiction to restrain a breach of trust or confidence." Thus, section 45 could be a marginal assurance that copyright registration does not destroy the confidential aspects of trade secrets.

In conclusion, the patent and copyright laws in Canada are only marginally effective in coping with rights to information in the computer industry. Accordingly, this thesis has chosen to concentrate on the trade secret and contractual obligations that apply to skilled employees.

D. TRADE SECRET PROTECTION FOR INFORMATION

1. The Legal Principles of Trade Secrets:

Trade secret law in Canada is a creation of the common law and equity, and has received almost no statutory recognition. However, the absence of trade secret legislation in Canada has not constrained the application and vigor of this area of the law.

English Courts have long recognized that legal and equitable relief should be granted to prevent what was termed a "breach of confidence". The dimensions of the duty of confidence imposed on an employee were summarized in the 1913 Chancery decision in Amber Size and Chemicals Co. Ltd. v. Menzel:
In my view, after giving the authorities the best attention I can, the law stands thus: The Court will restrain an ex-servant from publishing or divulging that which has been communicated to him in confidence or under a contract by him, express or implied, not to do so: Morrison v. Moat, 9 Hare, 241, and generally from making an improper use of information obtained in the course of confidential employment: Tuck & Sons v. Priestler, 19 Q.B.D. 629, and, further, from using to his late master's detriment information and knowledge surreptitiously obtained from him during his, the servant's employment: Robb v. Green, (1885) 2 W.B. 1, 315. 70

Outside of the employment relationship, plaintiffs have been able to obtain relief from the courts for breach of confidence whether the confidential information arose in a business setting,71 or was obtained outside of any quasi-contract or implied term of confidence.72 The common element is that the defendant must have obtained the information in such a way as to be bound by the obligations of confidence.73

Lord Denning's decision in Seager v. Copydex Ltd.74 illustrates the scope of the doctrine. The case concerned a plaintiff who had disclosed confidential product information to the defendant during negotiations which ended without the parties entering into a contract. However, the defendant thereafter used the plaintiff's information to develop and market its own alternative product. The plaintiff successfully sued and received a lump sum damage award from the Court.

In summary, Lord Denning affirmed that specific trade secrets in England are protected by the general theory of breach of confidence. The protection afforded the plaintiff was based upon:

[T]he broad principle of equity that he who has received information in confidence shall not take unfair advantage of it. He must not make use of it to the prejudice of him who gave it without obtaining his consent. 75
This formulation clearly protects information whether or not it was received in a business context.

Canadian courts have generally followed the basic principles established by the English jurisprudence. The statement in *Amber Size Chemicals* noted above was adopted by the Ontario Court of Appeal in *International Tools Ltd. v. Kollar*[^76]. In addition, the decision of *Seager v. Copydex* has been cited with approval in other decisions in Canada.[^77]

Canadian courts are also in agreement with Lord Denning's statement that the jurisdiction to restrain a breach of confidence does not depend upon an express term of contract. Almost two decades before *Seager v. Copydex*, the Ontario Court of Appeal in the well known decision of *Crain Limited v. Ashton and Ashton Press Mfg. Co.* stated:

> The cases on this subject of trade secrets establish that independently of any express covenant or contract, an ex-employee who, in the course of his employment, acquired a knowledge of a secret process belonging to his employer, arising out of the confidential relation between an employer and his employee, is under an implied obligation not to use that knowledge upon leaving his employment.[^78]

These general statements of the theory of breach of confidence lead to other legal questions that are important for information such as software. Is the right that is being violated properly viewed as a breach of confidence or as a violation of a trade secret? In fact and in law, are there any reasons for distinguishing between a trade secret and confidential information? Once these issues are resolved, a secondary question then emerges. Is a trade secret a substantive legal right, a property right or equity acting to deal with an inadequate legal remedy? This last question will be discussed in Chapter VI under the topic of Critical Remedies for Breach of an Employee's Obligations.

[^76]: *International Tools Ltd. v. Kollar*
[^77]: *Seager v. Copydex*
The first of the above questions is perhaps the easier to answer. Canadian cases clearly apply obligations of confidence after the existence of a trade secret has been proved. As in Computer Centre Personnel Ltd. v. Lagopoulos, Alberts (Edgar T.) Ltd. v. Mountjoy, or Molnar Lithographic Supplies Ltd. v. Sikatory, the courts accept that communication of trade secrets imposes an obligation of confidence upon the recipient.

Yet there are other important decisions in which confidential information has been protected in circumstances where the relief could not be based on the existence of a trade secret. In Slavutych v. Baker the Supreme Court of Canada upheld the confidentiality of a tenure recommendation written by a university professor. In Alberta Human Rights Commission v. Alberta Blue Cross Plan the Alberta Court of Appeal held that obligations of confidence could theoretically be applied to the personnel files of an employer. Even in cases on employment obligations, the courts do not find it necessary to first identify a trade secret. In decisions such as Chevron Standard Ltd. v. Home Oil Co. and Leeson (Alta. Court Of Appeal), and Guyer Oil Co. v. Fulton (affirmed by S.C.C.), the critical matter was whether there existed confidential information which had been communicated to the employee.

In spite of the ambivalence of the decisions, the distinction between trade secrets and confidential information is important. Although the obligation of confidence enunciated in Seager v. Copydex will protect both categories, the definition of trade secrets covers a much more limited range of information. One limitation is that information may be communicated and treated as confidential, yet not qualify as a trade
secret. Secondly, if the information is already in the public domain, the use of the information by a business cannot be a trade secret.

The definition of a trade secret contained in Section 757 of the U.S. Restatement of Torts confirms that trade secrets cover a more limited range of circumstances than the equitable obligations of confidence. Since the following definition limits trade secrets to use "in one's business", and to where the secret provides an "advantage over competitors", how could a non-profit research organization claim trade secret protection in the United States?:

A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process for manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.

Canadian authorities that have seriously considered the scope of a trade secret also adopted such a limited definition. In R.I. Crain v. Ashton 86a Chevrier J. accepted four similar descriptions of a trade secret taken from American cases. All of these definitions limited possession of trade secrets to commercial enterprises. Similarly, in Schauenburg Industries Ltd. v. Borowski 86b Craig J. correctly noted that even in a business context a distinction can be drawn between confidential information and a trade secret:

While it would not be correct to describe this process or the operation a trade secret, it is my opinion that it is confidential information. Borowski wrongfully used this confidential information; that is, in the sense that it had been entrusted to him as general manager and in the belief that he would not disclose it to the detriment of the plaintiffs. Information may be confidential if the whole result is not known
though its separate features or ingredients 'have been published or are capable of being ascertained by actual inspection by any member of the public': Ansell Rubber Co. Pty. Ltd. v. Allied Rubber Industries Ltd., [1967] V.R. 37 at p. 49.

Thus, one initial conclusion is possible. There are valid reasons for making the legal distinction between a trade secret and an obligation of confidence. The aforementioned cases indicate that the scope of a trade secret will be limited to parties in business where the secret is used to achieve a competitive advantage. However, obligations of confidence can be more widely applied to any persons who meet the essential criteria.

This thesis will be examining rights to information in the wide range of employment relationships associated with the computer industry. Since the organizations involved can range from private businesses to non-profit research units, the wider legal bounds of obligations of confidence generally will be more applicable than the narrower concept of trade secrets.

The courts have established prerequisites for the protection of information such as computer software. In effect, the equitable obligations of confidence protect both trade secrets and other types of information so long as three basic elements are established. As Megarry J. in the case of Coco v. A.N. Clark (Engineers) stated:

First, the information itself, in the words of Lord Greene, M.R. in the Saltman case ....must 'have the necessary quality of confidence about it'. Secondly, that information must have been imparted in circumstances importing an obligation of confidence. Thirdly, there must be an unauthorized use of that information to the detriment of the party communicating it.
In *Thomas Marshall (Exports) Ltd. v. Guinle*, the Chancery Division in England further clarified the three elements given in the Coco case. But again, Megarry V.C. was careful to recognize that the criteria for the protection of information could apply to either trade secrets or confidential information if the communication took place in an industrial setting. These requirements for the protection of information will be discussed in more detail in Chapter V under Section D - The Employer's Proprietary Interest and the Reasonableness Test.

2. Trade Secrets and Software:

There are legal, technical, and market considerations that identify trade secrets as the dominant non-contractual legal protection for information in the computer industry. As the previous two sections discussed, both existing copyright and patent laws are ill-suited for protecting the new information technologies. In contrast, trade secrets or the obligations of confidence are particularly suited to information activities such as software development and marketing.

Trade secrets protects confidential information that is being used by a business entity to maintain a competitive advantage. As discussed, an employee or an outsider who receives such information in confidence must respect and preserve that secret and equity will not permit the recipient to make use of the confidence to his own benefit.

In 1977, a survey was taken of the participants in the United States software industry. The survey asked participants to compare the legal protection offered by patent law, copyright law, trade secrets, and the possible protection offered by technical features such as cryptographic
coding, releasing of object program only, and other means of limiting program access. The survey concluded that trade secrets was the most widely used method of legal protection in the American industry.\textsuperscript{87a} It is the link between competitive advantage and secrecy that makes the doctrine of breach of confidence critical for the software industry. The computer sector depends heavily upon this legal doctrine for a number of reasons.

First, the computer marketplace is characterized by intense competition and rapid growth. Large market shifts of 10\% to 20\% occur over periods of two to three years due to the continual introduction of new products. The product life cycles of both software and hardware are relatively short. As Hammond observed, information has a short term frequency as compared to the longer term frequencies of the statutory monopolies (i.e., patent and copyright).\textsuperscript{88} At the same time, the speed of change in the software marketplace means that litigation is often self-defeating. Most vendors cannot afford to divert corporate resources into a lengthy court battle. All efforts must be directed to maintaining a competitive edge and keeping pace with each new generation of software. As a result, secrecy in the development and introduction of new products is a key factor.\textsuperscript{89} These industry characteristics also mean that legal emphasis is on immediate protection and interlocutory remedies rather than eventual trials to recover losses after the fact.\textsuperscript{90}

There are other market characteristics that link trade secrets closely to the protection of software. Information products are now being introduced in many industries to increase productivity and to cut labour
costs. However, these benefits can only be realized if information technology is allowed to play a major role in corporate operations. For example, the manufacturing sector will use the CAM (computer assisted manufacturing) systems as the heart of a manufacturing process. Therefore, once the new technology is introduced, the high degree of integration makes it difficult to then convert to another system.

In general, this phenomenon of software dependency increases the importance of trade secret protection for the computer industry. In most instances, companies which have automated their various accounting, manufacturing and reporting systems have long ago abandoned the parallel manual systems. Thus, the oft used marketing ploy is to discount the price of the first software module to establish the entry into the purchaser's operation. The enormous costs of converting to any rival software package creates the dependency. As a result of the lock-in effect of software dependency, vendors must be first in the market. Accordingly, there is enormous pressure to get advance warning about the new products and marketing strategies of competitors. Trade secret protection plays a major defensive role in preventing competitors from using unauthorized disclosure of information to secure a market lead.

Dominant companies in the information sector also try to control their markets through the strategy of "product differentiation". A large vendor will do everything possible to distinguish its products as being unique and incomparable to those of its rivals. For example, the software of one particular manufacturer normally cannot be used to operate the hardware of another manufacturer. In the same way basic information cannot be readily transferred from one software system to another.
Software incompatibility can be a vendor strategy rather than just a technical problem of ill-defined standards. Product differentiation, accordingly, heightens the dependency of a software purchaser upon that software vendor.

These factors raise the stakes for competitors in the information sector. Since the installed customer base is so important for continued sales, all producers must not be left behind in the product development race. These risks accentuate the piracy of information, bribery of employees and the general concerns over confidential information. The theory of trade secret deals with these risks by emphasizing the preservation of a business' competitive secrets.

However, it should be said that the theory of trade secrets is not the perfect protection for computer software. First, the widespread marketing and successful sale of a program will eventually destroy the trade secret by making the information public. The American courts have already dealt specifically with computer software being marketed under a restrictive licensing agreement. So long as the obligations of confidence are clearly and consistently maintained by the vendor licensor, it appears that a generous degree of mass distribution will be tolerated in the United States.92 However, the more liberal American approach on the publication of alleged trade secrets must be contrasted with the more restrictive approach taken by the High Court in Australia93 or the House of Lords in the United Kingdom.94

Second, the general theory of trade secrets does not prevent a competitor from independently developing the same software program from his own research. Finally, enforcing trade secret obligations against
former employees eventually conflicts with the doctrine of restraint of trade. This conflict will be discussed in depth in Chapter V.
FOOTNOTES: CHAPTER III

1. Dr. Stuart L. Smith, Chairman of the Science Council of Canada, in Canadian Business/Special Supplement, Fall/1983 at page SC2.


3. Supra., Chapter II.


5. Canadian criminal law has seen a dramatic increase in the number of prosecutions relating to confidential information and the computer industry in the past 3 years. Regina v. Stewart (1983) 149 D.L.R. (3d) 583, 42 O.R. (2d) 255 (Ont. C.A.) is a test case which raises the issue whether confidential information can be the subject of theft or fraud, and is currently on appeal to the Supreme Court of Canada. An earlier Supreme Court of Canada decision in Regina v. McLaughlin [1980] S.C.R. 331 held that the unauthorized access to and interference with a computer did not constitute a crime under paragraph 287(1)(b) of the Criminal Code. In Regina v. Kirkwood (1983) 5 C.C.C. (3d) 393, 42 C.R. (2d) 65 the Ontario Court of Appeal used subsection 338(1) of the Criminal Code to convict a videotape counterfeiter. (The circumstances of videotape piracy and software piracy are quite similar.) In Regina v. Turner (Ont. H.C.) June 18, 1984 reported in Case Comments (1984) 1 C.CL.R. 222, the accused were convicted of committing mischief to private property, being computer tapes, contrary to paragraph 387(4)(a) of the Criminal Code. See also Hammond, Grant R., Theft of Information (1984) 100 Law Quarterly

7. Id.
8. (1602) Cr. Eliz. 872; 78 ER. 1097.
10a. Chapter V discusses the doctrine in depth.
14. Source code or source programs must be contrasted to object code or object programs. The glossary for the (1983) Computers and the Law Institute materials (Continuing Legal Education Society of B.C.) provides the following explanations at pages 5:1:25 and 5:1:32:

Source program: a computer program written in symbolic language which will be converted into an absolute language object program using a processor program.
Object code: absolute language output from a compiler or assembler which is itself executable machine code or is fully complied and is ready to be loaded into the computer.


17. Id.

18. For example, the model conditions of contract used by the British Columbia Hydro Authority in acquiring computer systems sets out such a provision to protect the licensee.

19. Id.


20a. Chapter V Section 2 discusses the Special Status of Employment Restraints.


22. Id.


22b. Id., at p. 5.

22c. Id.

24. Id. note 23, at 55-56.

24a. Libling, D.F., The Concept of Property: Property in Intangibles (1978) 94 Law Review Quarterly 103 at 103, 104 where the author argues that Anglo-Australian case law recognizes property rights in intangibles based on the following principle:

An expenditure of mental or physical effort, as a result of which there is created an entity, whether tangible or intangible, vests in the person who brought the entity into being, a proprietary right to the commercial exploitation of that entity, which right is separate and independent from the ownership of that entity.


27. Supra., note 25, at 417


30. Sections B and C of this Chapter will identify recent Canadian decisions; see also George E. Fisk, Copyright Protection for Computer Software and Electronic Games, for seminar titled Legal Protection for Computers, Software and Electronic Games published by Oyez Limited, January 14th, 1982, at page 8.


33. For example, copyright protection has been applied to prevent the unauthorized videotaping of films in Warner Bros. Seven Arts Inc. v. CESM TV Ltd. (1971) 65 C.P.R. 215; and see Canadian Admiral Corp. Ltd. v. Rediffusion Inc. (1954) Ex. C.R. 382. The Supreme Court of Canada has upheld the copyright in a musical work even though the infringement took place after intervening productions via master tapes and then acetate masters. Compo Co. Ltd. v. Blue Crest Music Inc. et al. (1980) 105 D.L.R.(3d) 249.


35. Supra, note 31, sec. 56(1).

36. For a general overview of the legislation see D.A. Hill, Patents and Computer-Related Subject Matter at p.1 in seminar titled Legal Protection for Computers, Software and Electronic Games published by Oyez Limited Jan 14th/82.


40. Supra, note 38, at 206

41. Supra, note 36, at 7 referring to Section 12.03.01(g) of the Canadian Patent Office Manual of Examining Procedures.

42. Supra, note 36, p. 8

42a. "Firmware" and "chip" are defined in note 54. It can be argued that firmware or P.R.O.M. (programmable read only memory) chips represent physical technology that is patentable. However, the American experience suggests that this argument must be treated cautiously. See Backer, S.A., Means-Plus-Function Claims in Computer Related

42b. Id.

43. R.S.C., 1970, c-C-30, as am.


43c. Supra, note 43, sec 22.

43d. The issue of the liability for damages of an outsider who receives confidential information from an employee will be examined in Chapter VI - The Critical Remedies for Breach of an Employee's Obligations.

43e. Supra, note 43, sec 5.

44. Supra, note 43a, at 18; and see supra note 30 George Fisk, Copyright Protection for Computer Software and Electronic Games at 11.

45. Supra, note 14.

46. Supra, note 43, sec 3(1) (a).

47. Supra, note 43a.


49. Id.
50. Canadian Admiral Corp. Ltd. v. Rediffusion Inc. (1954) Ex. C.R. 382 at 386 which states that "for copyright to subsist in a "work" it must be expressed to some extent at least in some material form, capable of identification and having a more or less permanent endurance." The reference to material form is contained in the preamble to sec. 3(1) of the Act.

50a. See note 54 for an explanation of these terms.

50b. Szibbo, A., The Computer and Copyright in Canada Materials for Copyright in the 1980's published by The Continuing Legal Education Society of B.C. at Chapter 4, pg. 6, 7 and 30 (February 1985).

50c. Id.


52. For example, see B. Eischen, Revisions to the Copyright Act (1983) 1 Canadian Computer Law Reporter 25.


52b. Id., at pages 79-87.

52c. This was the opinion expressed by two panelists, Mr. Lance Turlock and Mr. Peter Grant, at the law seminar on "Copyright in the 1980's" organized by the Continuing Legal Education Society of B.C. held on February 15th, 1985.

53. (1983) 75 C.P.R. (2d) 26 (Ont H.C.)
54. **Supra**, note 14, at 5.1.07 and 5.1.16 where the Glossary provides the following explanations:

Firmware - a term usually related to microprogramming and those specific software instructions that have been more or less permanently placed into control memory. An extension to a computer's basic command (instruction) repertoire to create a user-oriented instruction set. This extension to the basic instruction set is done in read-only memory and not in software. The read only memory converts the extended user-specific instructions to the basic instructions of the computer.

Floppy disks - storage devices in the form of small flexible disks (about the size of 45 rpm phonograph records) used for random access requirements in controllers and CPU's and as a compact substitute for punched cards. A typical floppy disk provides capacity for about 300,000 data bytes. Floppies were originally developed for low cost, low capacity data storage, and relatively low data transfer rates. Also known as diskettes.

Chips - microprocessors that are complete computers on a single chip of silicon. No larger than 1/2-inch square, they contain all the essential elements of a central processor, including the control logic, instruction decoding, and arithmetic processing circuitry. To be useful, the microprocessor chip or chips are combined with memory and I/O integrated circuit chips to form a "microcomputer", a machine almost as powerful as a minicomputer. They usually fill no more than a single printed circuit board.

55. **Id.**


57. **Supra**, note 54.

58. **Supra**, note 53.

59. (1984) 75 C.P.R. (2d) 281 (Ont H.C.)

60. **Id.**

61. **Id.**, at p. 282.

63. Id., at p. 354 D.L.R.

63a. Id., at p. 354.

63b. Id., at p. 355.


63d. Id.

64. Supra, note 43a at 18.

64a. Supra, note 43, sec. 12(3). It should be noted that the white paper on copyright revision called "From Gutenberg to Telidon" supra note 52a, invites public comment on the issue of first ownership of copyright in the employment relationship, and briefly states the various arguments in Appendix II, pg 113-117.

64b. Supra, Chapter II at pg 17-20.


67. Id., at 192-193.


68a. Supra, note 43.

69. The statutory references to trade secrets in Canada occur in sec.45 of the Copyright Act supra, note 43 and perhaps indirectly in the Trade Marks Act 1952-53, c.49 s. 7 which prohibits any act or business practice contrary to honest industrial or commercial usage

70. [1913] 2 Ch. 239, at 244-245.


75. Id., note 74, at 416.

76. (1968) 67 C.P.R. (2d) 386.


82. Supra, Note 77.

82a. [1983] 6 W.W.R. 758, at 765-67 (Alta. C.A.). In this case the Court concluded that the evidence did not justify the imposition of confidential obligations.
85. Supra, note 74.
86. Restatement of Torts 757 (1939).
86c. Id., at 706.
86e. Id., at 47.
86f. [1978] 3 All E.R. 193 (Ch.D.) The elements will be identified and discussed in Chapter IV, Section D. under the heading of The Employer's Proprietary Interest and the Reasonableness Test.
86g. Supra., note 86f, at 209-210.
87. Supra, note 74.
88. Supra., note 24 in Chapter I.
90. Chapter VI discusses remedies and the importance of interlocutory injunctions for the protection of software.
91. See Gerald Brock, "The U.S. Computer Industry - A Study in Market Power" at page 89 where the author identifies the three structural
features of the computer industry that most affect price and product actions. The features are product differentiation, concentration (i.e., I.B.M.), and technical progress.


Chapters IV and V will discuss the specific information obligations that apply to skilled employees in the computer industry. The preceding Chapter III has concluded that patent and copyright laws do not provide decisive protection for information in the computer industry. This analysis will therefore focus upon the protection available to employers under the employment relationship.

The employment relationship can impose three distinct categories of legal obligations upon an employee: the implied obligations that arise from the employment relationship; the obligations imposed by the common law in the event that the employee is viewed as a fiduciary; and the express contractual obligations resulting from the employment agreement. This last category will be specifically discussed in Chapter V in the context of the doctrine of restraint of trade and the enforcement of restrictive covenants.

These three categories of obligations for employees must be discussed separately due to the contrasting level of responsibility which each places upon an employee. An employer who protects his trade secrets by using carefully drafted restrictive covenants, will be, in theory, entitled to greater protection than if he had relied solely upon implied obligations. Similarly, senior level employees who are deemed to be fiduciaries are subject to more onerous obligations than the lower level employees who operate under implied obligations. However, all three categories, impose a certain degree of responsibility, upon an employee to maintain the confidentiality of the employer's information.

There is another legal reason for discussing the interplay between implied, fiduciary and express obligations of an employee. Implied and
fiduciary obligations act as a backstop to the express contractual obligations. If a particular restrictive covenant is judged to be unreasonable, then the result is that the covenant is wholly unenforceable. The unfairness of this result for the covenantee/employer in part lead the Law Reform Commission of B.C. to recommend the partial enforcement of restrictive covenants.\(^1\) However, in the absence of this reform, the existing law produces an all-or-nothing protection for employers vis-a-vis express restrictive covenants.\(^2\) The ameliorating feature of the existing law is that express covenants do not displace an employee's implied or fiduciary obligations.\(^3\) If an express covenant is struck down, Canadian courts then move easily to a review of an employee's remaining fiduciary or implied obligations.\(^4\)

As discussed in the previous chapters, the difficulties which employers encounter in attempting to protect their confidential information and trade secrets are particularly acute in the computer industry. On the one side employers are forced into an increasing reliance on secrecy and confidentiality to comply with the industry wide practice of the restrictive licensing of software. On the other side, the changes in technology have made the employers more and more vulnerable to the misappropriation of software. More particularly, when skilled employees change jobs in the same sector of the computer industry, the fear is that they will inevitably reveal previously acquired confidential information to the new employer. The difficulty is that fiduciary and implied obligations cannot override the employee's right to use his skills and knowledge in competition with a former employer. The employee's interests in job mobility must be balanced against the protection of the employer's confidences and trade secrets.
Two conclusions will be apparent at the end of this chapter. First, the legal limits of employee's fiduciary and implied obligations are still evolving. The precedents are not uniform nor predictable in their application. Second, an employer achieves the strongest legal protection for confidential information with the use of express covenants; fiduciary and implied obligations are a secondary and less effective form of protection.

A. Implied Obligations:

Fiduciary obligations are imposed upon employees by the general common law. In contrast, implied obligations are most often considered as being the implied term of the employment contract. Thus, the law assumes that an employee has an implied obligation of good faith, honesty and loyalty to his employer during the contract of service. An employer is entitled to damages for the breach of those duties. In *State Vacuum Stores of Canada Ltd. v. Philips et al.*, the British Columbia Court of Appeal approved this view of implied terms in an employment agreement:

> The principle that an unfaithful employee may be answerable in damages is well established in the decided cases although, as Lord Greene M.R. points out in *Hivac Ltd. v. Park Royal Scientific Instruments Ltd.*, [1964] 1 All E.R. 350, this branch of the law may not yet have been fully explored in its remoter aspects. Bowen L.J. refers to the principle in this language in *Lamb v. Evans*, [1893] 1 Ch. 218 at p. 229:
> 'The common law, it is true, treats the matter from the point of view of an implied contract, and assumes that there is a promise to do that which is part of the bargain, or which can be fairly implied as part of the good faith which is necessary to make the bargain effectual. What is an implied contract or an implied promise in law? It is that promise which the law implies and authorizes us to infer in order to give the transaction that effect which the parties must have intended it to have, and without which it would be futile.'°
There have been numerous decisions in both English and Canadian courts which have applied the same principles. More specifically, these implied obligations of the employee have been widely used to protect the confidentiality of an employer's information. So long as the employee knows (or ought to know) that he is acquiring confidential information, then the employee cannot use the information in conflict with the interests of the employer. This general obligation of good faith with respect to confidential information clearly continues beyond the employment relationship.

These general principles have not yet dealt with the key question for skilled employees in the computer industry. What is the dividing line between the employer's confidential information and the skills, knowledge and general information that the employee can carry with him? What are the limits imposed upon employees by their implied obligations?

First, during the term of employment an employee's obligations of good faith and loyalty do not permit activities that conflict with the employer's interests. It can even be argued that an employee cannot work for another employer in his spare time, if the part-time employment raises the strong likelihood that confidential information will be disclosed.

Once the employment relationship has ended, the employee is free to use his acquired skills and knowledge in competition with the former employer. Absent any express covenants or the imposition of fiduciary duties, the ex-employee's relatively limited responsibility is to respect any confidential or secret information provided by the ex-employer. In *Herbert Morris Ltd. v. Saxelby* Lord Atkinson said:
... a man who goes into an office is entitled to make use in any other office, whether his own or that of another employer, of the knowledge which he has acquired in the former of details of office organisation ... the knowledge of the reasonable mode of general organization and management of the business of this kind, and to make use of such knowledge, cannot be regarded as a breach of confidence ... although the person may have learnt it in the course of being taught his trade;\textsuperscript{13}

Lord Shaw further separated the employee's knowledge from the employer's trade secrets by saying that:

... a man's aptitudes, his skill, his dexterity, his manual or mental ability — all those things which in sound philosophical language are not objective, but subjective — they may and they ought not to be relinquished by a servant; they are not his master's property; they are his own property; they are himself.\textsuperscript{14}

These statements confirm that an employer faces a difficult evidentiary burden when the employer tries to use implied obligations to protect confidential information. The solicitation of customers illustrates this point. If the employer can demonstrate that an employee had dealt exclusively with two major clients as the employer's sole representative, then it can be said that the employee has acquired information about these clients which is "special or peculiar"\textsuperscript{15} to the employer. Thus, the employee can be liable for damages resulting from the soliciting of these two clients immediately after termination of employment.\textsuperscript{16} However, where the ex-employee is simply using information that is available to all other competitors in the market, then the ex-employee can compete freely against the former employer.\textsuperscript{17} Since implied obligations are normally argued with respect to the lower-level, non-management and non-fiduciary employees, it is normally difficult to prove that such a junior employee has received special confidential information.

There is another dimension to the employer's difficulties in seeking to rely upon the protection of implied obligations. If the employer has
not thought it necessary to use express covenants to protect his information, a court is going to be rightfully suspicious about subsequent claims of confidentiality and proprietary rights. If an employer possesses unique technology or unique software, then the employer must use express covenants to separate these proprietary trade secrets from the general information or know-how to be received by the employee.  

In the case of *Printers & Finishers Ltd. v. Holloway et. al.* the employer possessed a unique printing technology that was unknown to other competitors. The employer was entitled to an injunction to prevent an ex-employee from taking any documents or photographs that described the secret process. However, in the absence of express covenants, the employer was unable to prevent the ex-employee from putting his general knowledge of the unique process at the service of a competitor. As Cross J. stated:

> If Mr. Elliott is right in thinking that there are features in his process which can fairly be regarded as trade secrets and which his employees will inevitably carry away with them in their heads, then the proper way for the plaintiffs to protect themselves would be by exacting covenants from their employees restricting their field of activity after they have left their employment, not by asking the court to extend the general equitable doctrine to prevent breaking confidence beyond all reasonable bounds.

This comment raises a rather dubious distinction that is sometimes drawn between the extent of implied and fiduciary obligations. A fine reading of the cases can derive the principle that, absent any express covenants, a non-fiduciary employee can use whatever information is retained in memory. The corollary is that a fiduciary employee's obligations do extend to include matters merely remembered. This distinction is of limited value because it misdirects attention to the form of the information rather than to its content. The correct approach is to measure the significance of the information to the parties and the
and the circumstances under which the information was received by the employee. The memory distinction ignores these underlying policy concerns.

However, the dubious distinction regarding memory does emphasize the relative weakness of implied obligations to protect the employer's information. The preceding discussion points out that express covenants are the critical way to move beyond the rudimentary and uncertain protection of implied obligations.

There is another weakness with implied obligations. The theoretical basis for implied obligations can be troublesome for employers, and especially for computer industry employers who deal with a unionized work force. The initial paragraphs in this section noted that implied obligations are generally assume to arise directly from the contractual relationship.\textsuperscript{23}

However, it is incorrect to say that an employee's implied obligations depend totally upon contract. In certain cases the contractual theory has been supplanted by the equitable concepts of breach of confidence. Thus, in \textit{International Tools v. Kollar}, the Ontario Court of Appeal extended the obligations of confidence to a third party outsider who stood to profit from any unrestrained breach of employment duties.\textsuperscript{24}

Another approach has been a rejection of the contractual basis for implied obligations. In \textit{Regina v. Fuller},\textsuperscript{25} the Ontario Court of Appeal preferred a wider statement of the source of implied obligations. Mr. Justice MacKay first noted the case authorities that identified the implied terms as being ancillary to the contract and observed:

\begin{quote}
In \textit{Pearce v. Foster} (1886), 17 Q.B.D. 536 at p. 539, Lord Esher, M.R., said: "The rule of law is, that where a person has entered into the position of servant, if he does anything incompatible with the due or faithful discharge of his duty to his master, the
latter has a right to dismiss him. The relation of master and servant implies necessarily that the servant shall be in a position to perform his duty duly and faithfully, and if by his own act he prevents himself from doing so, the master may dismiss him." Having regard to these authorities, while I think the duty could be said to be an implied term of both the contract of hiring and the collective agreement, for the purpose of determining the jurisdiction of the board, I prefer to state it as a duty established by the common law that is inherent in and attaches to the relationship of master and servant. The relationship of employer and employee being established, the duty attaches to the relationship as a matter of law, whether there is or is not a collective agreement.26

Another more recent decision of the Ontario Court of Appeal supports the notion that the implied obligations are established by the common law. In *Bee Chemical Co. v. Plastic Paint and Finish Ltd.*,27 certain express restrictive covenants were limited to a post-employment period of three years. The defendants had engaged in a flagrant use of their former employer's trade secrets throughout the three year period. Rather than trying to apply or extend the express limitation period, the Court simply issued a permanent injunction based upon the employee's implied obligations:

> We do not think we have any power to enforce the restrictions in the agreements for any period longer than is set out in the agreements, and that Parker, J., ought not to have done so. On the other hand, an injunction against the defendants restraining them from violation of their common law obligations need not be subject to a three year or any other limitation. In our view that injunction should be permanent.28

There are several important reasons for considering the source of the implied obligations. Firstly, there may be different limitations on remedies depending whether an employee's liability for misusing confidential information arises from contract or from general equitable obligations.29
Secondly, the contractual approach to implied terms may mean that this protection is not available to an employer whose skilled computer employees are unionized. This possible conflict arises from the Supreme Court of Canada's decisions in *McGavin Toastmaster v. Ainscough* and the earlier case of *Syndicat Catholique des Employés de Magasins de Quebec, Inc. v. Companie Paquet Ltee.*

It can be argued that these Supreme Court decisions have held that there can be no right or duties arising out of the employer/employee relationship except such as are spelled out in the collective agreement. Of course, such a ratio would only apply to those employment relationships already certified under the collective bargaining process. This argument is based upon certain statements of the Supreme Court to the effect that the common law is irrelevant once a collective bargaining agreement comes into force between the employer and the union. For example, in *Syndicat Catholique*, Judson J. in the majority decision stated that:

> There is no room left for private negotiation between employer and employee. Certainly to the extent of the matters covered by the collective agreement, freedom of contract between master and individual servant is abrogated. The collective agreement tells the employer on what terms he must in the future conduct his master and servant relations.

Then later Laskin C.J.C., in the *McGavin Toastmaster* decision stated:

> The reality is, and has been for many years now throughout Canada, that individual relationships as between employer and employee have meaning only at the hiring stage and even then there are qualifications which arise by reason of union security clauses in collective agreements. The common law as it applies to individual employment contracts is no longer relevant to employer-employee relations governed by a collective agreement which, as the one involved here, deals with discharge, termination of employment, severance pay and a host of other matters that have been negotiated between union and company as the principal parties thereto.
Admittedly, these statements were primarily dealing with items specifically covered in the collective agreement, and therefore might not prohibit an implied obligation as part of the contract of employment. However, the cases do reveal a potential legal problem for any employer who deals with unionized information workers. Certainly, the cases point out that any employer will have great difficulty in enforcing an express agreement of non-disclosure signed by an individual employee outside of a collective agreement.

As a side note, it is suggested that the problems of information protection in the unionized setting are wider than is immediately obvious. The reality is that many of the largest computer installations in British Columbia are staffed in the majority by unionized employees. Such installations would include the Insurance Corporation of B.C (I.C.B.C.), B.C. Hydro, B.C.Systems Corporation, and B.C. Telephone. For example, in October 1983 there were approximately 40 employees engaged in operating the main computer installation at B.C.Hydro. Thirty of these employees were members of the Office and Technical Employees Union (O.T.E.U.).35

In summary, an employer in the computer industry can rely upon the implied obligations of an employee for a degree of legal protection, but such protection is rudimentary.

B. Fiduciary Obligations:

The fiduciary concept covers too many factual situations to be given a comprehensive definition. Instead of looking for a rigid classification system, the courts examine the general characteristics of fiduciary relationships:

the power to act with respect to the property of
another; the reposing of trust, and reliance; the independent power of one individual to bind another to legal transactions; the relative power inherent in the nature of the relationships themselves and the ability of the parties to look out for their own interests.36

Thus, the relationships that can be classified as fiduciary are not limited in number. Historically, the common law has recognized a fiduciary relationship between trustee-beneficiary, director-company, promoter-company, solicitor-client, principal-agent, and partner-co-partner.37 However, this list does not exhaust the categories of possible fiduciaries. If the circumstances reveal that a relationship contains the necessary elements of trust, reliance and relative power, the court can impose a fiduciary obligation. Such responsibilities have been clearly imposed by the Supreme Court of Canada upon a limited number of managerial employees.

In Canadian Aero Service Ltd. v. O'Malley,38 Mr. Justice Laskin (as he then was) recognized that employers impose great trust, confidence and reliance upon certain employees. When such circumstances occur, the employee then has the higher obligations of a fiduciary. No longer are the employee's obligations limited to the implied obligation of non-disclosure of confidential information, or to the restriction against using confidential information to compete against the employer. As a fiduciary, the employee must regulate his conduct so as not to be in a position of conflict with the interests of the employer. Specifically, Justice Laskin looked at the defendants' role in the organization:

[T]hey acted in those positions (as president and vice-president) and their remuneration and responsibilities verified their status as senior officers of Canaero. They were "top management" and not mere employees whose duty to their employer, unless enlarged by contract, consisted only of respect for trade secrets and for confidentiality of customer lists. Theirs was a larger, more exacting duty which, unless modified by statute or by contract (and there is nothing of this sort here), was similar to that owed to a corporate employer by its directors.39
Laskin then described the defendants' positions as more akin to the fiduciary role of agents rather than that of mere employees:

Although they were subject to supervision of the officers of the controlling company, their positions as senior officers of a subsidiary, which was a working organization, charged them with initiatives and with responsibilities far removed from the obedient role of servants.

It follows that O'Malley and Zarzycki stood in a fiduciary relationship to Canaero, which in its generality betokens loyalty, good faith and avoidance of a conflict of duty and self-interest. Descending from the generality, the fiduciary relationship goes at least this far: a director or a senior officer like O'Malley or Zarzycki is precluded from obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested upon full disclosure of the facts), 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.\(^\text{40}\)

The first paragraph cited above sets out several important distinctions. First, it reinforces the separation between the implied, fiduciary and express obligations of employees. In substance, the quotation describes the difference between implied and fiduciary duties. However, Justice Laskin was careful to note that these categories could be "enlarged by contract"\(^\text{41}\), a clear reference to the use of express restrictive covenants.

Second, the passage points out that a glossy impressive title for an employee does not convert him into an instant fiduciary.\(^\text{42}\) The actual responsibilities and initiatives assigned to an employee are better indicators of fiduciary status than the organizational rank or title. The result is that any senior employee, in special circumstances of trust and confidence, can now be found to be a fiduciary. The classification as a fiduciary must not be applied rigidly, but once achieved, such obligations can extend beyond the end of the employment contract.\(^\text{42a}\)
In holding that on the facts found by the trial Judge, there was a breach of fiduciary duty by the president and vice-president which survived their resignations I am not to be taken as laying down any rule of liability to be read as if it were a statute. The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factors of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officer's relation to it, the mount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge.43

After the Canaero decision in 1973, a number of Canadian cases have classified senior employees as fiduciaries.44 However, the courts have been cautious to avoid any unreasonable extension of the concept. As in Alberts v. Mountjoy,45 the employee/fiduciary is usually a trusted general manager or senior executive of long service with the corporate employer. A lower level employee is not considered to be a fiduciary, unless the junior employee participates in the breach of the fiduciary duties. Estey C.J.H.C. (as he then was) noted the difference between implied and fiduciary obligations as follows:

In this case the defendant Mountjoy stood in a fiduciary relationship to the plaintiff and there was accordingly imposed upon him a "larger, more exacting duty" than a duty simply to respect his former employer's trade secrets and the confidentiality of its customer lists.

As well, where a defendant of lower rank such as the defendant Butt might have claimed immunity from the duties attaching to a fiduciary, he lost that advantage in joining with Mountjoy in the new business venture which successfully diverted the business opportunity of his former employer and fixed him with the same fiduciary duty as Mountjoy.46
The courts seem to be aware that widely extending fiduciary duties to lower ranking employees would cause other policy problems. In *Nelson Burns & Co. v. Gratham Industries Ltd.*, Mr. Justice Hughes rejected the fiduciary status for the defendant employees, and then urged care in applying the *Canaero* decision:

This case has been widely followed and has gone far to stimulate a tendency which can be discerned in recent decisions to narrow the ground on which an employee can safely leave his job and at the other end of the scale upon which an employer can safely discharge his servant. The latter has been in difficulties for a longer time than the former because of the rapidly growing popularity of actions for unjust dismissal. The principles of the marketplace, the laws of supply and demand, freedom of competition and freedom of action generally are always in retreat before measures taken and doctrines developed in the name of social justice, and it may be said with some confidence that if the tendencies I have referred to persist both master and servant will be locked into an enduring relationship from which they can escape only at heavy cost.

Other commentators have criticized the *Canaero* decision as leading to an emerging "unfairness principle" to be applied to the obligations of fiduciary employees. The complaint is made that fiduciary obligations are so vaguely defined and subjective that employees are left without any guidance except that they must refrain from unfair conduct. However, the objectivity of these critics is questionable.

In spite of these judicial and critical cautions, fiduciary obligations are clearly relevant to skilled employees in the computer industry. A chief programmer in charge of a major software development project meets many of the general characteristics of a fiduciary. Such a project ordinarily is conducted in confidence, is normally an expensive corporate undertaking and is usually of great significance to the employer's competitive position in the marketplace. Even though the chief
programmer might not be a senior employee of management rank, his important role in the research and development effort more than offsets the lack of traditional status. At the present time, the majority of employees in the industry probably do not satisfy the general characteristics of a fiduciary. However, as the confidentiality, expense, and business significance of software development steadily increases, the fiduciary concept will raise the level of legal obligations placed upon the key employees.

In summary, fiduciary obligations impose higher standards of confidentiality and good faith upon employees than those required by the category of implied obligations. However, computer industry employers face two serious difficulties in relying upon the protection offered by fiduciary theory. First, how does an employer know when a particular highly-skilled employee will be classified as a fiduciary? The preceding discussions has shown that the case law is still evolving, and that fiduciary status depends upon a complex variety of subjective factors. Second, even if an employee is deemed to be a fiduciary, the employer must still prove the existence and limits of the confidential information passed on to the employee. In other words, fiduciary obligations are not a retroactive solution to an employer who has initially failed to separate general employment information from the alleged confidential information. The real solution is that the employer should have protected the confidential information through carefully drafted restrictive covenants in the employment contract.
C. Fiduciary Obligations and the British Columbia Software Industry

The preceding discussion points out that many of the highly-skilled employees who are intimately connected with a major software development project are likely to be considered fiduciaries. This proposition raises a number of unresolved policy issues when it is considered in the context of the B.C. software industry. In effect, this analysis will conclude that a widening gap exists between the industrial strategies that are required for the success of this fledgling industry and the associated legal theory. In summary, if the B.C. software industry is to grow and prosper, it must share information, engage in cooperative marketing, and avoid wasteful duplication of effort. Such activities raise many unresolved conflicts of interest for the key employees and managers who have a fiduciary status.

First, an overview of the B.C. industry and the wider software market is required. A recent report by Touche Ross & Co. provides the necessary data.\(^\text{51}\) In North America, all segments of the software market are expanding at a dramatic rate. Growth is predicted to be in excess of 30% per annum throughout the decade of the 1980's.\(^\text{52}\)

The Canadian market is expected to grow from an estimated $608 million in 1981, (the most recent year for which data was available) to $2.3 billion in 1986, an average annual growth of 31 percent. The American market annual growth rate during this period has been forecast at 34 percent - from $3.7 billion (U.S.) in 1981 to $16.2 billion (U.S.) in 1986. The American figures exclude custom software which, in 1981, was reported to be $1.5 billion (U.S.). Thus, the total North American market, which in 1981 was less that $6 billion, (U.S.), is estimated to be over $20 billion (U.S.) by 1986.\(^\text{53}\)

However, B.C. software suppliers rely mostly upon B.C. markets for their revenue (approximately 80% of gross revenues), and have only a minimal penetration of markets in Eastern Canada and in the United States.\(^\text{54}\)
At the end of the research report, Touch Ross & Co. summarized the typical B.C. software supplier. More than half of the companies reported revenues of less than $100,000 in 1982, and employed less than 5 people. Such a corporation typically:

- is managed by a proprietor or small group of partners whose backgrounds and interests are primarily technical;
- lacks the marketing knowledge and expertise required to compete strongly in the package-oriented markets of the 80's;
- does not have sufficient finances or borrowing power to invest heavily either in extensive product development or in marketing;
- has inadequate understanding of how to prepare and present a business plan which will influence prospective sources of funds for product and marketing development;
- often invests time in developing products which are similar to others already developed which have competitive advantages;
- emphasizes doing functions, often to the exclusion of managing functions.56

This description of the typical software supplier in B.C. leads to a number of assumptions about legal protection. First, the general lack of managerial expertise combined with the pronounced technical orientation means that legal protection is generally ignored. Such corporations rarely make use of non-disclosure or non-competition agreements. Even if such restrictive covenants are initially executed by the parties, the covenants do not specifically define confidential information, and are not part of an ongoing program to maintain the secrecy of the information. This lack of regard for express covenants means that fiduciary obligations then become a more important legal protection for the B.C. software supplier.

A second assumption is that many of the individuals involved in these companies are likely to be classified as fiduciaries. First, the general organization style is egalitarian rather than hierarchical. Information
is shared freely among the individuals involved, rather than access to confidential information being limited to a need-to-know basis. Important strategic decisions are made by consensus, rather than by one single individual. This emphasis on a partnership style of operation means that the key people are likely to have multiple roles as skilled employees/officers and managers/directors. The degree of confidence, trust, and reliance placed upon such individuals may make them into fiduciaries.

Is the status of fiduciary an appropriate one for such individuals? What are the conflicts in interest produced by this classification?

Initially, the fiduciary status is consistent with industry emphasis on restrictive licensing agreements for the distribution of software. These agreements transfer software to users under strict obligations of confidence. Software suppliers are therefore engaged in the business of confidence are complimentary to these software transfer arrangements.

However, fiduciary obligations are difficult to reconcile with broader industrial strategies that must be undertaken to assure the survival of the B.C. Industry. The Touche Ross & Co. report isolated a list of possible strategies. As well, it should be remembered that the report was commissioned jointly by the federal and provincial governments, and will undoubtedly be considered in setting industrial policy. The remedial list included, in part:

- **Development of an Industry Marketing Association**
- **Networking Agreements Between Suppliers**
  These informal agreements would deal with the problems of scarce resources and access to markets by encouraging cooperation in product development and in the provision of support services.
- **Organization of Industry-Wide Training Activities**
- **Collection and Dissemination of Information on Products and Market Developments**
- **Rationalization of the Industry Through Mergers**
It is not suggested that an individual's fiduciary obligations cannot be reconciled with this well intentioned industrial action plan. However, the action plan emphasizes sharing of information for training, marketing and product development, and the transfer of information through mergers. This basic premise that software companies should share and transfer information is not always consistent with basic fiduciary obligations.

For example, consider the skilled experienced programmer who wishes to instruct in an industry-wide training program. His corporate employer depends upon confidentiality to protect its software products. How can the altruistic instructor discuss the details of these confidential software programs with other programmers, and still not breach his fiduciary obligations?

Similarly, software companies duplicate each other's development efforts due to a lack of sharing of information. Networking agreements and marketing associations are a logical solution to avoid this waste of scarce resources. But how can the manager of a software supplier openly discuss the intimate details of his company's development and marketing programs without compromising his fiduciary obligations? It must be remembered these discussions will be with competitors in the same industry.

Again, it is not suggested that these conflicts are irreconcilable. Once the problem is identified, the individual employee could obtain the employer's consent to the necessary disclosure in a limited forum. Confidentiality agreements and security arrangements could be used to control the release of the information to a specific group of outsiders. Many such variations of this nature could be used to resolve the conflict.
However, it is suggested that such a sophisticated approach to industry-wide undertaking is improbable. The suppliers are not presently using non-disclosure agreements to protect themselves internally. It is unlikely that the more remote, external threats of fiduciary conflicts would change the present practice.

Thus, the gap between the strategies for industrial growth and the strategies for legal protection is widening. Industry survival calls for elimination of duplicate effort and the sharing of vital information on products, marketing and training. At the same time restrictive licensing arrangements and fiduciary obligations demand that the key employees involved meet strict obligations of confidentiality. The conclusion is that many of these key employees will increasingly be in breach of their fiduciary obligations due to their ignorance of the law.

2. Id. at p. 34-36 outlining the current position in law when a restrictive covenant is unenforceable. The theory of severance can arguably provide a court with a choice of covenants to enforce and thereby avoid leaving the covenantor totally unfettered. See p. 63-69 for a discussion of overreaching and severance.

3. Chapter V at p. 115-17.


6. Id., at 625.


13. *Id.* at 704.

14. *Id.* at 705.


16. *Id.* at p. 153.


18. Chapter V at p. 137-141 discusses the distinction between trade secrets and know-how.


20. *Id.* at p. 736.

21. *DCF Systems Ltd. v. Gellman* (1979) 41 C.P.R. (2d) 145 at p. 157. Osler, J. of the Ontario High Court states that employees "in the absence of restrictive covenants, ... have a right in such circumstances to make use of information they have retained in their memories regarding former clients or customers".


26. *Id.* , at 567.
28. Id., at 135.
29. This classification issue will be discussed in Chapter VI on Critical Remedies for Breach of An Employee's Obligations.
32. For example, see Robitaille v. Vancouver Hockey Club Ltd. (1979) 19 B.C.L.R. 158, at p. 167 (B.C.S.C.).
33. Supra., note 31, at 353-54.
34. Supra., note 30, at 6.
35. As per interview with Mr. Ken Wright, Security Officer, B.C. Hydro on a tour of the computer installation at 970 Burrard Street, Vancouver, B.C..
37. Id., at 568-69.
39. Id., at 381.
40. Id., at 381-82.
41. Supra., Note 39.
42a. For an updated summary of the authorities on this point see B. Love Ltd. v. Bulk Steel and Salvage Ltd. (No. 2) (1982) 141 D.L.R. (3d) 621 (Ont. H.C.) at p. 625-6 stating that a fiduciary cannot use confidential information for his own benefit after the termination of employment.
43. Supra., note 38 at 391.


46. Id. at page 119.


48. Id., at 711.


50. The objectivity of the authors is questionable since at p. 510-12 they rely upon the discussion in Nelson Burns & Co. Ltd. v. Gratham Industries Ltd. et. al. (1984) 150 D.L.R. (3d) 692 as the prime example of an 'incorrectly applied unfairness principle. The authors conclude that the court denied costs to two defendants in spite of their success in the litigation. The authors attribute the court's motive to a moral distaste for the defendant's legal conduct. The authors fail to state that the plaintiff was successful in an accompanying patent infringement action against the defendant's personal corporation. The plaintiff was also successful against a third co-defendant on a breach of restrictive covenant. Thus, the Trial Judge exercised his discretion and refused costs to all parties except on the patent infringement issue. The authors also fail to state that P.Y. Atkinson was the counsel for the two defendants described in the article as being "successful".

52. Id. at p. 52.

53. Id. at p. 53.

54. Id.

55. Id.

56. Id. at p. 51.

57. The writer is Chairman of the Computer Law Committee of the Commercial Law Subsection in Vancouver, and a member of the Canadian Information Processing Society. Discussions with both lawyers and computer industry representatives from these groups confirms this conclusion.

58. Supra., Chapter III at p. 40-41.

59. Supra., note 51 at p. 52.3.
COVENANTS IN RESTRRAINT OF TRADE

The preceding chapter explored the implied and fiduciary obligations which are applicable to skilled employees in the computer industry. Even though these obligations do provide varying degrees of protection for an employer's confidential information, the last chapter concluded that express covenants provide the most effective protection.

This chapter will discuss the limits to the protection provided by express covenants. Since express covenants of confidentiality or non-disclosure are imposed by contract, the discussion will not consider the alternate theoretical sources of confidential obligations such as equity, property, trust or fiduciary relationships. This issue of the source of confidential obligations does arise when an employee passes confidential information to an outsider who is not bound by contractual obligations. The extent of an employer's rights to claim damages from such a third party will be reviewed in Chapter VI dealing with critical remedies.

The courts control the use of express restrictive covenants via the doctrine of restraint of trade. In essence, this doctrine is a statement of social policy. The Supreme Court of Canada in 1935 aptly presented the competing tensions associated with employment covenants in restraint of trade.

Public policy, as interpreted by the Courts, requires on the one hand that employers be left free to protect from violation their proprietary rights in business, and on the other hand, that every man be left free to use to his advantage his skill and knowledge in trade.

These competing tensions are easy to identify in the computer industry. After training and supervising an employee for a number of years, an employer is economically damaged by the departure of that
employee. The loss is aggravated when the employee then sets up a business that competes directly with the former employer.

To avoid being used as a training ground for future competitors, more sophisticated employers require new employees to agree to non-competition clauses in the initial employment contract. If the potential employee is to be given access to confidential information, a prudent employer will also require the employee to agree to a non-disclosure clause. These express covenants of non-competition and non-disclosure are used to prevent the release of confidential information after the termination of employment. Such clauses are an employer's primary source of legal protection against an employee who potentially could misuse the business's goodwill, customer lists, trade connections or confidential information.

On the other hand, such widely defined restraints can operate to make an employee the prisoner of the employer. Without the right to offer his services to competing employers, an employee is tied to the original agreement. The public interest suffers if free competition in the labour market is impeded by the widespread use of these types of restrictive clauses.

These competing interests have challenged the courts in Britain, Canada and the United States for over three hundred years. The persistent struggle to maintain a reasonable balance between these contrary demands produced the doctrine of restraint of trade.

A. Why Should Employers Use Express Covenants of Restraint?

Under the doctrine of restraint of trade, the protection available to an employer is limited generally to goodwill and confidential
information. This protection, which must meet the tests of reasonableness, does not ordinarily allow the employer to prohibit employees from later becoming competitors of the business. Lord Atkinson summarised the employer's position in the case of *Herbert Morris v. Saxelby* where he stated:

He is undoubtedly entitled to have his interest in his trade secrets protected, such as secret processes of manufacture, which may be of vast value. And that protection may be secured by restraining the employee from divulging the secrets or putting them to his own use. He is also entitled not to have his old customers by solicitation or such other means enticed away from him but freedom from all competition per se apart from both these things, however lucrative it might be to him, he is not entitled to be protected against. He must be prepared to encounter that even at the hands of a former employee.³

The limits of the legal protection that can be claimed for the confidential information and for trade secrets will be closely examined in the next sections of this chapter. A major difficulty has always been the drawing of the line between the employee's right to use his knowledge and skill to compete with the employer and the right of the employer to protect his proprietary interests. Thus, the employer must demonstrate that the covenant to be enforced only goes so far as to reasonably protect the employer's goodwill or trade secrets.

Before the detailed discussion of the underlying legal principles, the incentives for the use of express covenants should be more closely reviewed. Why is it imperative that a computer industry employer take restrictive covenants from employees at the time of hiring?

One contrary view is that an employer is automatically protected by the signing of the employment agreement even without express covenants.
Under the theory of implied obligations a limited amount of protection is available against former employees. As well, the preceding chapter noted that the Supreme Court of Canada has recently expanded the fiduciary duties of management level employees. In *Canadian Aero Service Ltd. v. O'Malley et al.*, Laskin J. refers to the "general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or a senior officer must conform,...". However, the discussion in Chapter IV concluded that fiduciary duties and implied obligations provide only minimal protection for computer industry employers. Instead, employers are compelled to use restrictive covenants in employment contracts for the following reasons.

(i) **Wider interests can be protected via the use of express covenants**

It is easier for a court to enforce a contractual undertaking, voluntarily entered into by the employee, than rather vague, general equitable obligations. So long as an express covenant is reasonably necessary to protect the employer's interests, a court will enforce the restriction. A reasonable covenant can even be enforced by an outright prohibition against an employee's right to compete, if such a prohibition is justified in the circumstances. Both the Supreme Court of Canada in the *Elsley* case⁵, and the High Court of Australia in *Geraghty v. Minter*⁶ enjoined former employees and partners from outright competition in order to enforce express covenants. Even though these cases factually dealt with solicitation of customers by the ex-employee or ex-partner, the legal ratios are clearly applicable to the computer industry. As the *Elsley*
decision observed, the covenant was enforced to prevent the ex-employee from using "the special and intimate knowledge" which he had acquired in the course of his employment. Thus, the central concern is the protection of the employer's unique and valuable information.

A similar advantage for an employer appears in those cases dealing with more limited prohibitions against the solicitation of customers by a former employee. If there was an express covenant against solicitation, then the employer can achieve a wider protection than would be available via fiduciary or implied obligations. For example, the decision of Estey, C.J.H.C., as he then was, in Alberts et al. v. Mountjoy et al. points out the weaker position of the employer who lacks specific covenants. Subject to certain cases which hinge on the employee's ability to memorize customers' names, a former employee, in the absence of restrictive covenants can solicit his previous employer's customers.

(ii) **Express covenants assist in proving the confidentiality of the employer's information.**

Whether an employer is seeking the enforcement of contractual or equitable obligations, the employer must still demonstrate the existence of confidential information that deserves protection. If the employer cannot prove that the information was always treated as a secret, then the court can make contrary assumptions. In G. D. Searle & Co. v. Celltech Ltd., before the English Court of Appeal, the plaintiff's claim for an injunction against its former employees was dismissed because it had failed to bring home to its employees the secrets which they were to
preserve. Cumming-Bruce L.J. observed that "The usual procedure by which a business protects itself from competition from its employees is a restrictive covenant; that is conspicuous by its absence in the relevant contracts."\(^{10}\)

Thus, the employer must fashion his own legal protection for confidential information. In the absence of an express covenant, the courts will not imply a restraint of trade that is tailored to the specific commercial needs of the employer.\(^{10a}\)

(iii) The awareness and deterrent value of express covenants.

There is a direct value derived from putting the employee on notice regarding obligations of secrecy. By highlighting the employee's obligations of confidentiality, express clauses have far more impact on laypeople than the vague implied or fiduciary duties. Each employee who reads his employment contract prior to termination notes the post-employment restrictions. Supervisors can reinforce this awareness by continued references to the clauses. If an employee seeks legal advice before accepting another job, the restrictions will be specifically mentioned in the legal opinion.

There is also a deterrent value relative to any prospective employer who is interested in hiring the employee. Job applicants who are unencumbered by restrictive covenants are favoured over those applicants who appear to be in breach of a covenant. Aside from any ethical constraints, employers are reluctant to hire an individual whose former employer might be entitled to bring injunction proceedings.
Finally, there is a deterrent value with respect to outside third parties who might try to obtain a business' confidential information. Once the employee is aware of the express obligations of secrecy, then any third party will likely be aware of security precautions. Such knowledge on the part of the outsider may allow the employer to obtain an injunction.\textsuperscript{11} The third party may also be subject to the criminal law provisions that have been prosecuted more rigorously in recent confidential information cases.\textsuperscript{12}

(iv) \textit{Injunctions can be issued more easily for express covenants.}

Once an express covenant has passed the tests of reasonableness, the court then turns to the remedy that will most effectively protect the employer's interest. If the employer is worried about his trade secrets, the normal remedy is an interlocutory injunction to prevent immediately any unfair use or unauthorized disclosure.\textsuperscript{13}

The more specifically an express clause defines the trade secret, the greater are the employer's chances of being granted an interlocutory or permanent injunction. The courts will resist any claim for a broadly worded injunction since the employees right to compete and to earn a livelihood must also be respected. A common drafting practice adopted by employers is to define narrowly a series of express covenants in the employment agreement. Even if one or two of the clauses are struck down as being too wide, then it is hoped that the other more limited provisions will be enforced.\textsuperscript{14}

(v) \textit{Express covenants do not displace implied or fiduciary obligations.}

An employer is not forced to choose between express covenants or the protection provided by the general obligations of an employee. It is
suggested that the decision of Farwell J. in *Triplex Safety Glass Co. v. Scorah* proper states the relationship between an express clause and the implied obligations. In this particular case, the express clause provided that the "said records knowledge or information gleaned or discovered by the Assistant Chemist shall be the exclusive property of the Company." The court refused to enforce the express covenant since it failed to distinguish the employer's trade secrets from the know-how that could be legitimately possessed by the employee. However, Farwell J. then held that the employee was still under certain implied obligations in spite of the failure of the express clause. Specifically, Farwell J. stated "it cannot be that, because a servant covenants in his contract of service to behave properly and honestly towards his employer and that contract of service as a whole is too wide to be enforceable, he is thereby entitled to be as dishonest and to act as unfairly as he pleases towards his employer. That obviously cannot be so and that contention does not afford a good answer to the Plaintiffs' claim."17

In 1981 the Ontario High Court in *Investors Syndicate Ltd. v. Versatile Investments Ltd.*18 refused to imply another term after an express covenant was defeated. The decision of Mr. Justice Reid initially appears to be in conflict with the ratio of *Triplex Safety Glass*. However, Mr. Justise Reid made it clear that he was being asked to imply a term that would replace the express term already declared to be void. Even if such a narrowly based term could be implied, Reid J. noted that the same public policy objections would apply to strike it down.19 More importantly, the Ontario Court of Appeal subsequently rejected any
suggestion that there is no scope for common law remedies once an express clause has been declared invalid.20

(vi) Express covenants establish an employer's claim to inventions.

In chapter III the current position on the protection of software via patent and copyright laws was presented. In general, these statutes are not completely effective in establishing an employer's rights to software or any other information related discovery.21

However, an employer should not ignore the marginal benefits of these laws. When disputes between employers and employees arise over ownership of patent or copyrights, the wording of the employment contract normally decides the outcome. In the absence of express covenants, the issue rests on the implied or fiduciary obligations placed upon the employee. For example, Hunter and Sharpe reviewed the patent rules on employee inventions and came to the following conclusion:22

The basic premise insofar as ownership of an invention is concerned is the same in the English, Canadian and American instances. In a nutshell, inventions belong to their inventor, and the rights of others must be derived from an assignment or license granted by the inventor or his successors, until such time as the patent expires. Reduced to the situation of the employed inventor, or the employee who invents, the invention belongs to the inventor and the employer's interest therein arises by virtue of the inventor's obligations incident to his employment contract.23

The Copyright Act also specifically refers to agreements of copyright between an employer and employee.24 To take effective advantage of the copyright presumption, an employer should specifically see that the ownership issue is settled in the employment agreement.
This review of the relevant factors leads to a summary conclusion. There are compelling legal and policy reasons for an employer to take express covenants of non-disclosure and non-competition from an employee at the time of engagement.

B. Special Status of Employment Restraints:

Chapter III explored four factors that are creating unanticipated imbalances in the employment relationships. Three of these new factors were created or influenced by the strong shift to an information based economy. Thus, the problems involved with the increasing commercial reliance on secrecy, the confusion over ownership of software, and the policy objections to property rights in information present a mixture of social and legal concerns. However, the fourth factor identified in Chapter III is more strictly limited to the law. This factor dealt with the existence of policy biases in our current law. In effect, is the special bias for employees in the doctrine of restraint of trade an inappropriate bias for the computer industry?

This employee bias has a lengthy history. Heydon notes that the theory of restraint of trade arose historically in respect to three types of contracts. Initially recognised by the English courts in the eighteenth century, the three categories allowed reasonable restraints for the protection of goodwill after the sale of a business, for the protection of a partnership against the competition of a former partner, and for the protection of an employer against a present or former employee. As Heydon observes, the restraints imposed on an employee were only reasonable if they did no more than "prevent an employee stealing away the employer's customers or revealing his secrets."
This separation of the three types of restraints permitted the courts to confer a special status on employment restraints. Thus, Canadian courts demand a higher standard of proof to enforce an employment restraint than for a restraint that protects the goodwill in a business. As early as 1935, the Supreme Court of Canada held that judges should be more reluctant to enforce an employer and employee covenant than when the covenant related to business goodwill.29

This thinking was rooted in the judicial awareness of the inequality in bargaining power that existed in most employment relationships. Lord Denning expressed the judicial concerns well in the 1957 case of M. & S. Drapers v. Reynolds:

"During the past 40 years the courts have shown a reluctance to enforce covenants of this sort. They realise that a servant has often very little choice in the matter. If he wants to get or keep his employment, he has to sign the document which the employer places before him; and he may do so without fully appreciating what it may involve. Moreover, if these covenants were given full force, they would tend to reduce his freedom to seek better conditions, even by asking for a rise in wages: because if he is not allowed to get work elsewhere, he is very much at the mercy of his employer.30"

This higher burden of proof has recently been applied by the Supreme Court of Canada. In 1978, Mr. Justice Dickson in the Elsley case31 had to categorize a particular covenant in order to decide what standard of proof was appropriate. The decision was that the restrictive covenant, in order to be enforceable, had to "stand up to the more rigorous tests applied in an employer/employee context."32
There are some serious questions about the continued validity of this anti-employer bias. More particularly, can such a bias be justified for the skilled employee in the computer industry? The arguments in favour of the distinction have been summarised as follows:

(i) in the case of an employment contract there is usually inequality of bargaining power between the parties and the employee has no effective say as to the terms of his employment (excluding the case of unions and collective bargaining).

(ii) by giving up his right to compete an employee may be losing his only asset, for little remuneration. The seller of a business, however, will have the capital raised from its sale.

(iii) when a business is sold it would often be valueless without a covenant not to compete. An employee's labour, however, remains valuable whether or not he later competes.

(iv) the existence of a post-employment restraint increases an employer's power over his employee since it removes from the employee's threats of resignation much of their bargaining strength.

(v) the existence of post-employment restraints diminishes competition, distorts the market and results in economic inefficiencies.

Should the restraint of trade doctrine continue to be applied with a standard of proof favouring the employee? In most information related sectors of the economy, these traditional arguments are somewhat unconvincing.

Computer operators, programers, integrated circuit designers, and data processing managers are typical information employees who can move easily from employer to employer due to a lack of trained personnel. Where experienced employees are in short supply, it is difficult to argue an inequality in bargaining power. Perhaps the inexperienced employee will not be able to negotiate freely his initial employment contract, but
this disability is eliminated as soon as the employee acquires marketable skills. In addition, the modern information employee rapidly acquires other negotiating arguments than that of resignation. A key programmer or a project manager who has been given access to his employer's confidential software has acquired certain leverage over his employer. Such information always has a value to competitors in spite of restrictive covenants. An information employee might also gain knowledge of the technological security systems and access codes that protect an employer's software and data bases. An employee's threat to publicize the details of these systems must be taken seriously. The costs of changing the security systems is worrisome for the employer, but an even greater concern is the potential damage to the employer's business reputation. Employers such as financial institutions, time sharing bureaus, utilities and numerous branches of government must maintain public confidence in the integrity of their security systems. The final result is that the modern information employer is increasingly vulnerable to the loss of a trusted employee.

Fifty years ago, a typical industrial employer could limit access to his trade secrets, and normally experienced a low turnover rate for his work force. Today, a software developer uses the law of trade secrets as his primary legal protection. However, such a developer can hardly keep the secrets hidden from the very employees who are responsible for the production and marketing of the software.

In summary, there are two major developments that reject a biased standard of proof in favour of the modern information employee. First, high skilled information employees are sophisticated and independent individuals who move frequently and easily between employers. Litigation
to protect an employer's interests against such individuals is expensive and disruptive enough without being faced with an exaggerated burden of proof. Second, the information employer is far more dependant upon his key employees for the success of his business, and far more vulnerable to the loss of confidential information. For these reasons, it can be argued that the bias of proof in favour of the employee should be rejected in the computer industry.

In practice, the courts may actually pay little serious attention to the higher standard of proof for employment restraints. The different standard for enforcement of employment restraints may not be a severe hardship for information employers. Although the employer's burden is discussed, this initial distinction is seldom a critical turning point for employment restraints. The courts emphasize the reasonableness of the particular covenant far more than the vague general standards of proof. So long as the employer clearly proves that the employee had access to trade secrets, to confidential information or to business connections, the courts will allow a reasonable protection for those interests.

The Supreme Court of Canada's decision in the Elsley case illustrates this point. Elsley had been the manager of a general insurance business for over seventeen years, and had dealt exclusively with the customers. At issue was the adequacy of a non-solicitation clause for the protection of the intimate and special knowledge acquired by the employee. Mr. Justice Dickson observed that "Whether a restriction is reasonably required for the protection of the covenantee can only be decided by considering the nature of the covenantee's business and the nature and character of the employment." In the end, Elsley was
prohibited from establishing his own business or working for others so as to be able to use the special knowledge to capture the customers of his former employer. Such a broad covenant was the only type of restraint that could reasonably protect the employers special vulnerability to the loss of that employee.36

Instead of dwelling upon evidentiary burdens, Mr. Justice Dickson stressed that each employment restraint must viewed in light of the business relationship between the parties:

It is important, I think, to resist the inclination to lift a restrictive covenant out of an employment agreement and examine it in a disembodied manner, as if it were some strange scientific specimen under microscopic scrutiny. The validity, or otherwise, of a restrictive covenant can determined only upon an overall assessment, of the clause, the agreement within which it is found, and all of the surrounding circumstances.37

The court was strongly influenced by the facts that Elsley had managed the business for seventeen years and had thereby acquired all of the details of the business. This strong identification of the general manager with the business justified a much higher degree of protection for the employer. Thus, the doctrine of restraint of trade recognizes that an employer can be much more vulnerable with respect to a management level employee than to one in a salesman's position. The same reasoning would apply to employees who are granted varying degrees of access to confidential information. A higher degree of access would then justify a higher degree of restraint.

The Supreme Court of Canada's reasoning in the Elsley case indicates that the initial burden of proof in employment restraint cases is of relatively little importance. Far greater weight is given to the precise
interests that the employer claims to be protecting, and to the reasonableness of the protection. Therefore, the special status of employment restraints is largely a theoretical rather than a practical bias in favour of the employee.

C. What is a Restraint of Trade?

What is meant by a restraint of trade? How have the Courts defined such a restraint in the context of the employment relationship? In 1920, the English Court of Appeal started from the basic principle that every person has the right to freely contract for the disposition of their skills and knowledge. Thus, a general definition of a restraint of trade then became the following:

A contract whereby a restraint is imposed upon the liberty of an individual to earn his living or exercise his calling, or in other words, a contract whereby the individual liberty of action is interfered with and controlled is a contract in restraint of trade.38

This early statement of a restraint of trade has been accepted by more recent authorities. For example, Cheshire and Fifoot's "Law of Contract" uses a similar wording whereby, "A contract in restraint of trade is one by which a party restricts his future liberty to carry on his trade, business or profession in such manner and with such persons as he chooses".39

Several recent cases in Canada and Britain have distinguished between existing restraints and future restraints. In this context, a restraint of trade can only exist if an individual contracts to give up some legal right which he already possesses. Thus, an express covenant that either limits the scope or the geographical area of an employee's activities during employment is not a restraint of trade. Similarly, in a
non-employment case, an individual who purchases a piece of property that is already subject to restrictive covenants has not given up a legal right. Such a purchaser cannot argue that the restrictive covenants are in restraint of trade. In an example that is relevant to the computer industry, a licensing agreement that provides for the payment of royalties past the expiry of a related patent is not a restraint of trade. None of the covenantors in the preceding three examples were giving up a future right to carry on their trade or business.

However, the courts are not easily mislead by the various disguises placed upon restraints of trade. They examine the substance of the contractual arrangement, and not just the wording of the particular covenant. The Law Reform Commission points out that the following employment covenants have both been held to be in restraint of trade:

- a stipulation that certain payments were subject to the recipient's conduct not being detrimental to the payor's interests invoked to prevent the recipient from taking employment elsewhere;
- a requirement that training expenses be repaid should the employee leave;

However, a stipulation that commissions due and owing should not be paid if a salesman took employment elsewhere, was enforceable against the covenantor.

Generally the restraint of trade doctrine applies to non-disclosure or non-competition clauses that are invoked by the employer after the termination of the employment relationship. A more specific and unusual application is the control of the employee's off-duty activities during the relationship. Two questions are thereby raised. Can the doctrine of restraint of trade be applied to moonlighting by the employee, and if so, under what circumstances can the doctrine be used to set aside covenants?
The initial difficulty in applying the doctrine during the employment period arises from the concept of a restraint of trade. As previously mentioned, the accepted definition is that as used by Chesire and Fifoot whereby a restraint of trade is a restriction on future liberty to carry on a trade, business or profession. Accordingly, the notion of freedom of contract allows an individual to accept employment restrictions in return for an employer's promise of compensation. Thus, one early English case specifically ruled that the doctrine could not be applied to any employment covenant where the restraint was confined to the employment period. The earlier Canadian authorities were not as specific in limiting the doctrine, but instead analysed the problem using the servant's contractual obligations. Except where a servant's outside activities put him in a conflict with the duty of loyalty and good faith owed to the master, the servant's spare time was not subject to the control of the master.

These earlier positions have now been clarified by several authoritative English decisions. It now appears that the doctrine can apply during an employment period, but only under certain limited circumstances. In Instone v. A. Schroeder Music Publishing Co., a young composer entered into a five year employment contract whereby he agreed to transfer to the publisher his world copyright in all compositions produced during that period. On appeal to the House of Lords, Lord Reid stated that:

Any contract by which a person engages to give his exclusive services to another for a period necessarily involves extensive restriction during that period of the common law right to exercise any lawful activity he chooses in such manner as he thinks best. Normally the
doctrine of restraint of trade has no application to such restrictions: they require no justification. But if contractual restrictions appear to be unnecessary or to be reasonably capable of enforcement in an oppressive manner, then they must be justified before they can be enforced.\(^5^1\)

In the Instone case and in Clifford Davis Management Ltd. v. W.E.A. Records Ltd.,\(^5^2\) a subsequent decision of the Court of Appeal, the restrictive covenants in favour of music publishers were set aside. The employment agreements in both cases were sharply biased in favour of the employers, and grossly inadequate compensation was promised to the employees. In the Clifford Davis judgment, Lord Denning referred to the unconscionability of the contract as part of the grounds to set aside the offensive clauses.

Therefore, the general conclusion must be that the doctrine of restraint of trade normally does not apply so as to invalidate restraints confined to the employment period. The limited exception occurs when the restraints are so extensive and unfair as to invite the court to interfere.

Given this definition of a restraint of trade, how do the Courts achieve the balance between the rival interests of employer and employee? The initial modern authority is Lord Macnaghten's statement in the Nordenfeldt case:\(^5^3\)

The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is sufficient justification, and indeed it is the only justification, if the restriction is reasonable - reasonable, that is, in reference to the interests of the parties concerned and reasonable in
reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.  

This formulation of the law on restraint of trade has been clearly accepted in both the English and Canadian courts. In the last six years alone, the Supreme Court of Canada has twice used Lord Macnaghten's statements as representing the appropriate principles of law. 

Given this widespread agreement on the basic approach, what are the legal tests that emerge from these authorities? The Ontario Court of Appeal in Tank Lining Corp. v. Dunlop Industrial Ltd. recently set out a four stage inquiry that is required by the doctrine of restraint of trade. Mr. Justice Blair noted that the proper questions were:

1. Is the covenant under review in restraint of trade?
2. Is the restraint one which is against public policy and, therefore, void?
3. Can the restraint be justified as reasonable in the interests of the parties? [and]
4. Can it also be justified as reasonable with reference to the interests of the public?

The subsequent sections of this chapter will apply this four part inquiry to those employers and employees who are involved in the computer industry. The first question to decide is whether the restraint actually forms a restraint of trade, and this issue has already been discussed.

As postulated in the Tank Lining case, the element of public policy is the second question addressed by the courts in dealing with a restraint of trade. Then, the court should ask whether the restraint of trade is so offensive as to be void by reason of public policy.
However, when dealing with employment restraints, it is quite normal for courts to bypass this second question without much serious consideration. This lack of attention to the public policy element results from countless employment cases have which have assumed that employment restraints are prima facie void.60

Recent Canadian and English authorities are suggesting that this failure to separate the public policy element from the subsequent tests of reasonableness will adversely affect the doctrine of restraint of trade. For example, Cheshire and Fifoot61 argue this point by referring to the House of Lords decision in *Esso Petroleum Co. v. Harper's Garage (Stourport) Ltd.*62 This case involved the application of the doctrine of restraint of trade to new marketing and sales arrangements called solus agreements. The authors emphasise that restraint of trade theory developed as a doctrine of public policy, and that the "changing face of commerce must always be borne in mind. Restrictions which in an earlier age were classified as restraints of trade may, in the different circumstances of today, have become 'part of the accepted pattern of structure of trade' as encouraging rather than limiting trade."63

In effect, the courts could use the public policy element to recognize the unique confidentiality problems associated with the development of software.

The Ontario Court of Appeal in the *Tank Lining* case specifically adopted the cautions of Cheshire and Fifoot, and then carefully distinguished the element of public policy from the test of reasonableness in the public interest.64 In summary, these authorities are cautioning against rigidities in the doctrine of restraint of trade. To ignore the
initial test of public policy risks limiting the doctrine's ability to reflect changes in economic conditions.

But it is doubtful that the public policy on employment restraints will soon change. The conclusion must remain that covenants which restrict competition by an employee against his former employer are prima facie void.65

D. The Employer's Proprietary Interest and the Reasonableness Test

The core of the doctrine of restraint of trade has always been the reasonableness of the limitation being placed upon the employee. To determine the validity of the restraint, the courts look at the nature of the employer's interest being protected, the geographic scope of the restraint and the duration of the restraint. The employer's protected interest is the special focus of this section.

Chapters III and IV, dealt with the importance of confidentiality and secrecy in the computer industry. Chapter III explained that most software is distributed via restrictive licensing agreements which impose obligations of confidence upon the licensors. Subsequently, Chapter IV pointed out the weaknesses in relying upon an employee's implied or fiduciary obligations to protect confidential information. Thus, employers in the computer industry should be keenly interested in using express covenants to protect their trade secrets. This section examines the limits to the proprietary interest that a computer industry employer is allowed to protect under the doctrine of restraint of trade.

What types of employer's interests qualify for the protection? An overview of the law was presented in Routh v. Jones:66
In the absence of special circumstances, an employer has no such proprietary interest as entitles him to protection from the competition of his former servant per se, nor can a former servant be restrained from turning to account his own business or professional skills, although that skill was acquired while he was in the service of his former master. On the other hand, where the circumstances are such that the servant has, by virtue of his engagement, been put in the position of learning his master's trade secrets, or of acquiring a special or intimate knowledge of the affairs of the customers, clients or patients of his master's business or of means of influence over them, there exists a subject-matter of contract, a proprietary interest or goodwill in the matter which is entitled to protection, since otherwise the master would be exposed to unfair competition on the part of his former servant — competition flowing not so much from the personal skill of the assistant as from the intimacies and knowledge of the master's business acquired by the servant from the circumstances of this employment."

This statement summarizes the law being applied to employer's interests in Canada today. In general terms, the interest must be recognised by the courts as a proprietary interest: commercial or business advantages are insufficient to satisfy the requirement. At the present time, the case law defines three general types of proprietary interests that the employer is allowed to protect. These are business connections or customer goodwill, confidential information relating to the business, and any trade secrets revealed to the employee. Each of these three types will be reviewed in turn:

1) Protection of Employer's Business Connections

At first glance, this type of employer's interest does not appear to involve any rights to confidential information. In this area, the employer simply wants to protect his business and customers from a competing former
employee. There does not have to be the loss of a customer list, nor does the employee have to have removed other confidential documents. Rather, the employee have been dealing directly with the employer's customers, and thereby has achieved a position of great personal influence with the customers.

However, the employee's position of influence really means that the employee has acquired a special type of information that is unavailable to competitors. As noted in Routh v. Jones67 the employer is entitled to be protected from the unfair competition that is based on ex-employee's intimate knowledge of the business. It should be noted that such knowledge falls short of the status of trade secrets or confidential information.

Laskin J. (as he then was), dealt with this type of case in Cameron v. Canadian Factors Corp. Ltd.68 In the majority decision for the Supreme Court of Canada, Laskin J. observed:

The present case is untrammelled by any contention of wrongful appropriation of a customer or client list, or of the wrongful use of trade secrets or confidential information. Nor does it engage the line of cases dealing with the sale of a business or of good will whose value at the time of the transaction depends on the purchaser being entitled to its exclusive use. It raises simply the principle on which Courts act against contractual undertakings by an employee not to compete, and I embrace in this last phrase the prohibitions in paras. 2 and 3 of the contract letter. That principle, whether under the Civil Code provisions as to public order (as in arts. 13 and 990) or under the common law, is the application of a rule of reason to a balancing of the interests of the employer and the erstwhile employee in respect of the need of the former for protection of his business and of the latter for economic mobility, in the light of a policy that discourages limitations on personal freedom, and, specifically, on freedom of economic or employment opportunity.69
Most restraint of trade cases involving employees will not present this straightforward choice between the employee's right to compete and the employer's right to protect his business. Instead, the usual case presents at least some minimal threats to the trade secrets or confidential information possessed by the employer. However, the Canadian Factors case shows that an employee does not possess an absolute right to compete: the employer's proprietary rights in his business will also be protected.

Western Inventory Service Ltd. v. Sager\(^7\) (Ont. H.C.) and Western Inventory Service Ltd. v. Flatt\(^7\) (B.C.S.C.) are two other examples of recent cases where an employer's non-confidential relationships with its customers were protected against the unfair influence of former employees.

2) Protection of an Employer's Interest in Confidential Information

The earlier discussion in Chapter III dealt with the general requirements for the existence of confidential information.\(^7\) The discussion also commented on the distinctions between confidential information and trade secrets.\(^7\) Although in most business situations the terms can be used synonymously, a non-business entity cannot hold trade secrets. Accordingly, the categories have been discussed separately in this chapter, even though there are many similarities in the basic principles of law.

Canadian courts recognize that an employer has proprietary rights to information related to the business. In many of these cases, no distinction is drawn between trade secrets and confidential information. Thus, in Management Recruiters of Toronto Ltd. v. Bagg,\(^7\) a departing
employee who removed 32 job orders and 148 prospect files was subject to a restraining injunction. The order was granted to prevent the employee from utilizing this information in breach of an express confidentiality and non-disclosure clause. Computer Centre Personnel Ltd. v. Lagopulas applied the principles in Routh v. Jones to employees who had acquired the special or intimate knowledge of the affairs of the employer's customers.

These cases illustrate the second major area in the continuum of an employer's proprietary interests. Although such employees may also have had a strong personal influence over the employer's customers, the biggest threat to the employer arose from the employee's unrestricted access to important business information. As noted previously, universities, government offices, societies and other non-profit organizations must claim a proprietary interest in confidential information rather than trying to establish a claim to trade secrets.

3) Protection of an Employer's Rights to Trade Secrets

Since trade secret theory was generally reviewed in Section D of Chapter III, this section will deal with trade secrets specifically regarding employees in the computer industry.

The employer must first prove that it is the legitimate owner or holder of the trade secret. Although this point seems obvious, the Ontario Court of Appeal in 1972 dismissed an appeal for the enforcement of a restrictive covenant on the simple grounds that the plaintiff was not the owner of the proprietary interest requiring protection. More importantly, the information that the employer seeks to protect must be proved to be a trade secret.
What types of information qualify as an employer's trade secret?

Heydon provides these examples of trade secrets:

What is included under "trade secrets"? The standard examples are processes, formulae, information about customers (e.g. their names and details useful in compiling advertisements about them), information the first publication of which has value, workable scientific ideas and physical objects produced by the use of the employer's time, money or labour in future (e.g. advertisement printing blocks, order books, plans or drawings). Thus, in the recent Ontario decision in Management Recruiters of Toronto Ltd. v. Bagg, 32 job orders and 148 prospect files qualified for protection because the information was highly valued in the industry and closely guarded. The courts have even extended trade secret protection to a single secret number (an optimum heat transfer coefficient).

Similarly, in the computer industry, software is developed and marketed in secrecy, and requires considerable investments of time and money. This leads to software being distributed as a trade secret.

But an employer cannot make software into a trade secret simply by naming it to be so. Using an analogous example, not all customer lists can qualify as trade secrets. In T.S. Taylor Machinery Co. Ltd. v. Beggar, the Manitoba Court of Appeal rejected an employer's proprietary interest in its customer list where all of the plaintiff's customers were well known to its competitors. Instead, the court recognized that the employer had a legitimate non-confidential interest in its customers due to the employee's considerable personal influence with the customers.

The analogy of customer lists also shows that an employer cannot claim a trade secret in software if the information was independently developed by an employee. Thus, an employer's proprietary interest in
its own business or trade connections cannot be enlarged to include previous customers of the employee. If customers follow an employee into an employment relationship, the same customers can again follow the employee after he departs from the relationship. In the same way, an employer cannot claim a proprietary interest in customer lists developed by an independent sales representative who later becomes an employee.

In addition to customer-related information, an employer can claim proprietary interests in information relating to manufacturing processes, production developments and unpatented inventions. In the context of the computer industry, typical trade secrets would include:

a) Software (object code and source code)
b) Documentation associated with software (user manuals, flow charts)
c) Designs, drawings and models
d) Internal specifications and testing, editing procedures
e) Customer lists
f) Market information covering financing, pricing policies and price lists
g) Bidding policies and procedures
h) Data and data bases
i) Employee discoveries or inventions
j) Work related ideas or concepts

In any industry, information must have been continuously maintained as a secret in order to qualify as a trade secret. Any proprietary claim is destroyed if the secrets were revealed through open marketing of the product. Once the secret was exposed by sale of the product, the information passed into the public domain and can be used by anybody,
including the former employee who received the original secret.89 An employer can protect product information prior to public sale, but secrecy must have been maintained during the development period.90 This reasoning does not preclude carefully controlled product distribution to the public in order to maintain the obligations of secrecy.91

Where an employer has allowed frequent visitors into the workshop area to view the alleged secret, and has failed to advise employees in writing of the need for security, no proprietary trade secret can be claimed.92 After the confidentiality is lost, enforcement of a restrictive non-disclosure clause against the employee is no longer possible.93 However, the intentional appropriation of confidential information by either employees or outsiders raises the possibility of criminal prosecution under recent Canadian authorities.94

4) Know-How versus Trade Secrets

In popular usage, the term know-how means the "practical knowledge of how to do or accomplish something with smoothness and efficiency; ability to get something done with a minimum of wasted effort; accumulated practical skill or expertness."95 The concept is potentially helpful since it defines a type of information that can be possessed and carried by a skilled employee. If the employee's ownership of his personal knowledge can be defined, then the legal limits to an employer's proprietary interests in information can be clarified. Both the American and British courts have approached an employer's proprietary rights using this distinction.
Much has been written in legal articles about the similarities and differences that exist between these two concepts. Yet a completely satisfactory legal definition of know-how does not exist. Dessemontet, in an exhaustive treatise on the legal protection of know-how in the U.S.A., decided that know-how was a matter of knowledge rather than one of manual skill. He noted that many American writers limited know-how to secret information, but in the end admitted to a hopeless confusion with the many different legal definitions. Similarly, Wheeler recently reviewed a number of the American decisions dealing specifically with trade secret protection in computer software. Her conclusion highlights this critical problem:

"Because of the uncertain dividing line between the employer's protectable rights in a specific program design or combination and the programmer's skill and experience, the cases involving trade secret protection in the computer industry employment relationship present particularly difficult questions. Courts, while attempting to balance these competing interests, have been unable to achieve a uniform and equitable solution."

The Anglo-Canadian courts have not yet dealt with the specific issue of an employee's know-how in computer software. Moreover, the general distinctions that currently exist do not offer much guidance. For example, Lord Shaw's judgment in Herbert Morris, Limited v. Saxelby provides a broad distinction between objective knowledge that belongs to the employer, and subjective knowledge that is the property of the employee.

Trade secrets, the names of customers, all such things which in sound philosophical language are denominated objective knowledge - these may not be given away by a servant; they are his master's property, and there is no rule of public interest which prevents a transfer of
them against the master's will being restrained. On the other hand, a man's aptitudes, his skill, his dexterity, his manual or mental ability—all those things which in sound philosophical language are not objective, but subjective—they may and they ought not to be relinquished by a servant; they are not his master's property; they are his own property; they are himself.102

Such a broad distinction separates the two extremes of information, but really doesn't help a court to determine the claims to the practical knowledge that lies between. Wheeler summarizes this problem in the computer industry by reference to a 1978 action against an ex-employee/programmer.

"Key employees have access to items of confidential business information, many of which are often assimilated into their general knowledge. If a second employer asks a computer programmer to develop a program to solve a particular problem, this programmer will undoubtedly draw upon the knowledge and experience gained while with the first employer. If the employee uses confidential information of his first employer to solve the second employer's problem, it is conceivable that the second employer could acquire some of the first employer's trade secrets."103

Another more pragmatic approach to this problem was taken by Cross J. in Printers and Finishers Ltd. v. Holloway.104 This decision suggests that the court can be guided by a reasonable employee's view of the ownership question. Thus, a court can recognize an employer's right to all information which "can fairly be regarded as a separate part of the employee's stock of knowledge which a man of ordinary honesty and intelligence would recognize to be the property of his old employer and not his own to do as he likes with."105 Following this reasoning, an employer's proprietary rights to know-how would end where the reasonable employee felt free to use the information as his own property. In the words of Cross J., "The law will defeat its own object if it seeks to
enforce in this field standards which would be rejectable by the ordinary man." Other courts have used this approach to restrain an employee whose primary function was to coordinate research, or to refuse an injunction where the employee himself was clearly adhering to this same separation of property rights.

However, this distinction between an employee's general knowledge and the specialized knowledge belonging to the employer cannot be applied to the computer industry. Given that a software company's entire product line are sold as trade secrets, how does the reasonable employee separate his know-how from the employer's trade secrets? It should also be noted that skilled programmers also become highly specialized in certain software designs. If the programmer is successful, his specialization is then reflected in the specialized software products sold by the employer. Both the employer and the employee are dependent upon the same specialized pool of knowledge.

In summary, the writer agrees with a recent conclusion drawn by Hammond. His view is that the distinction between general and specialized knowledge, or between know-how and trade secrets has been rendered almost meaningless in the computer industry.

In summary, the concepts of know-how and trade secrets cannot provide infallible rules for choosing between the rights of employers and employees. Ultimately, courts will always have to identify the employer's proprietary interests by paying careful attention to the parties, their conduct and to the industry within which the business operates.

There remains one other distinction that is vaguely related to the preceding discussion of know-how. At various times English and Canadian
courts have referred to the employee's right to use whatever information that he can carry in his memory. Initially, the memory test was used in England to separate an employer's casual information from information which required an organized effort to accumulate and copy. Then several early courts in the Western provinces, including the British Columbia Court of Appeal, adopted a more literal version. So long as the ex-employee had not made any written lists, the employee was permitted to use whatever information he could memorize. Subsequent courts in England and Canada continue to refer to the memory test, although a more recent qualification states that an employee cannot appropriate confidential information or trade secrets via memorization.

The memory test for determining proprietary rights in information must be rejected as artificial and inappropriate. Electronic filing, disk storage, personal computers and data transmission via telephone lines are examples of modern technology that permit effortless duplication of information. The scope of an employee's proprietary rights should not be determined by the amount of effort required nor by the method by which the information is appropriated. More broadly, focusing upon the employee's ability to memorize ignores the public policy rule of the doctrine of restraint of trade. The real concern must be to balance the protection of the employer's confidential information against the employee's right to compete freely.

5) Other Related Proprietary Interests

Software licensing agreements must be considered for their impact on the proprietary rights of employers. As noted in Chapter III, software
vendors transfer their products via licensing agreements which treat the software as a proprietary trade secret. While the software vendor can legitimately claim to hold a proprietary interest, what is the position of the licensee? The software user's position must be considered since it is contractually obligated to protect the developer's trade secret. Usually the vendor or developer requires that the user place its own employees under obligations of confidence. More cautious vendors even go so far as to sign confidentiality contracts directly with the user's agents, consultants or employees to eliminate privity of contract problems.

First, the software licensing agreements ordinarily do not directly create a restraint of trade. The vendor and the user do not normally contract to restrict any future liberty to trade. Employers who voluntarily exchange mutual restrictive covenants that limit future dealings, such as in *Tank Leasing Corp. v. Dunlop Industrial* or *Kores v. Kolok*, are the exceptions rather than general commercial practice.

The significant questions arise with the software users who have placed their employees under obligations of confidence. Such an employer cannot claim to be protecting its own proprietary interest pursuant to the doctrine of restraint of trade. What the software user is really trying to protect is its own right to continued use of the software. If the user's obligations of confidence are broken by a user's employee, then the software licence can usually be terminated by the unilateral act of the vendor. Thus an unanswered question in Canadian law exists. Can a software licensee claim a sufficiently wide proprietary interest in its use of software, so that it can protect the software against a former employee?
One related purpose of an express covenant, in the situation being discussed, would be to place the employee(s) under the more general equitable and fiduciary obligations of confidence. Once the employee knows that the software represents a trade secret that belongs to the vendor, then the vendor has some hopes of direct action against the employee and outside parties. However, this point still does not answer the proprietary interest status of the licensee.

Certain judicial comments relating to the scope of the interests covered by the doctrine have arisen in Australian cases involving oil companies and restrictive sales agreements. A limiting position was initially taken by the trial court in Mobil Oil Australia Ltd. v. McKenzie. It was said that "the interests must be in the nature of proprietary rights and ... a commercial interest, as distinctly from one involving some right of property, would not, unless the legal principles already applied should be extended, be sufficient." Then the High Court of Australia expanded the scope of the protectible interests in Amoco Australia Pty. Ltd. v. Rocca Bros. Motor Engineering Co. Ltd.

The comments of the High Court in the Amoco case were adopted by the Ontario Court of Appeal in Stephens v. Gulf Oil Canada Ltd.

It is not in doubt, in my opinion, that Amoco was entitled in the circumstances to obtain the benefit of a trade tie in aid of the recoupment of its investment and in aid of training interests arising out of its agreement to supply its products to Rocca. The question is whether or not the term of the tie, considered in conjunction with the covenants to which I have referred, was greater than was reasonably necessary.

In effect, these decisions appear to conclude that commercial or trading interests can be recognized as an adequate basis for the
doctrine. Thus, a strong argument can be made that a software user's investment and trading interest in the licensing agreement are sufficient grounds for protection under the doctrine of restraint of trade.

In summary, an employer can claim proprietary rights in his business connections, and in his confidential information and trade secrets. For the modern employer, who is either using or developing software, the latter category increases daily in importance. However, the distinction that the common law insists on drawing between know-how and trade secrets is of little value to the computer industry.

E. Reasonableness Between the Employer and Employee

Once a court satisfies itself that a computer industry employer has a legitimate interest to protect, the court then turns to the reasonableness of the protection being claimed. In effect, does the restrictive covenant achieve an effective balance between protecting the employer's information and preserving the employee's future liberties?

However, the balancing of the interests of employer and employee cannot be a straight compromise. Since public policy directs that all employment restraints are prima facie void, then the covenant must be justified as being a reasonable restraint. The restriction can only go so far as to adequately protect the employer's interest. If the covenant exceeds reasonable limits in either the scope of protection, in the duration of the covenant or in the geographic extent, then the restraint will be void and unenforceable.
How does a court answer these questions of reasonableness? The overall answer must be that the court looks closely at the particular facts of each employment relationship. Each decision must be highly dependent upon the evidence presented by the parties. Littlewood's Organization Ltd. v. Harris illustrates this subjective approach. The Court enforced a covenant not to work for one specific competitor in the first twelve months after termination. Given the nature of the industry, and the particular nature of the confidential information possessed by the employee, the Court's conclusion was that such a covenant has the only way of protecting the employer's position. With such a level of subjectivity, the common law has not developed any specific rules to guide the courts on reasonableness. However, there are a number of general principles relating to the test.

First, early cases developed the rule that the adequacy of the consideration given to the employee was immaterial. A more general statement appears in Lord Parker's decision in Herbert Morris Limited v. Saxelby, where he stated that the court should not "weigh the advantages accruing to the conventor against the disadvantages imposed by the restraint." The relative hardship to the employee was not critical in determining whether the restraint was reasonable. Today's courts also de-emphasize the advantages or disadvantages to the covenantor. The accepted general approach is still whether the restriction only goes so far as to protect the interest of the employer.

However, the hardship to the employer and the adequacy of the consideration has received some judicial attention in more recent years. Lord Macnaghten had included a dictum in the Nordenfelt case to the effect that the court may have greater freedom to hold restraints as unreasonable
where there has been inadequate consideration. Lord Reid, in *Esso Petroleum Company Limited v. Harpers Garage (Stourport), Ltd.*, approved this dictum.

Second, the relative obligations undertaken by both parties strongly influenced the Court of Appeal and subsequently the House of Lords in *Instore v. A. Schroeder Music Publishing Co.* The case bordered on unconscionability due to the inequality in bargaining power between the parties and the totally inadequate consideration promised to the employee. On the basis of this extreme set of facts, the restrictive covenant was set aside due to the relative unfairness of the bargain. This decision and associated non-restraint of trade cases such as the British Columbia Court of Appeal's judgment in *Harry v. Kreutziger* (an unconscionable sale of a fish boat), lead the Law Reform Commission to conclude that the courts have expressly adopted "tests of fairness and conscionability to determine the reasonableness of covenants in restraint of trade".

Heydon maintains that the relative bargaining powers of the parties have been considered in other ways. The author states that a shortage of skilled labour, the bargaining power of a strong union, or the negotiating skills of the convenantor, have affected a court's decision on reasonableness.

The time for judging the reasonableness of the restraint was between the parties has been agreed to be the time of the granting of the covenant. The British Columbia Court of Appeal earlier applied this principle in *Green v. Stanton*. The court further held that reasonableness in the public interest must also be judged at the time the
employer received the covenant. These principles were accepted by the Supreme Court of Canada in *Doerner v. Bliss & Laughlin Industries Ltd.*

(i) Duration and Geographic Extent of Restrictive Covenants

These two elements require separate consideration if an employer's goodwill and customers are being protected. Customer lists change as time progresses, and customers are also spread throughout different geographical areas. The reasonableness of a restraint must be tested against each element. Where an employer's interest concerns confidential information or trade secrets, then the two elements can be discussed together. Non-disclosure is the primary protection for trade secrets: as soon as the information is revealed to the public, the secret disappears. Therefore, the duration of the non-disclosure restraint ranks as the primary test of reasonableness, and any geographic restraint means very little.

Once again, testing the reasonableness of any restraint must be a highly individualized exercise. However, a court looks at certain peculiar facts when the employer claims protection for a trade secret in software. Reference is made to a recent American decision since reported Canadian cases have not as yet dealt with restrictive covenants being applied to protect software. In the United States, the case of *Analogic Corporation v. Data Translation, Inc., et.al.*, was appealed to the Supreme Judicial Court of Massachusetts in 1976. The plaintiff corporation had hired two employees to develop a high speed data acquisition module which took eighteen months to complete with development costs in excess of $100,000. These employees subsequently left the employ of Analogic and, with a third person formed the defendant company to develop a similar data
acquisition module. When leaving Analogic, both former employees executed termination agreements which provided, inter alia, that they were not taking any documents or materials belonging to Analogic. The trial court found that these defendants did use drawings, documents and a sample of the plaintiff's module.

The defendant's development costs to produce a copy of the plaintiff's module were limited to $2,500.00. The defendant corporation had then marketed its version of the module at a price comparable to, or less than, the plaintiff's.137

Restraint of trade principles similar to those previously reviewed in this chapter were applied by the Massachusetts Court. It was held that a covenant restricting competition will be enforced to protect a trade secret if it "is reasonably limited in time and space, and is consonant with the public interest."138 The court of first instance entered judgement of $12,714.75 against the defendants and issued a perpetual injunction against their manufacturer and distribution of the module. The defendants appealed.

The duration of the injunction was the key issue on the appeal. Interestingly, the case was remanded back to the lower tribunal in order to clarify and add essential facts to the record. In so doing, the appeal court made the following observations:

- Our holding today is not to be interpreted to require that the duration of an injunction be inflexibly determined by the amount of time necessary to reverse engineer the plaintiff's device without improper use of trade secrets. But evidence as to this time period is one factor which should be considered in determining the reasonableness of the scope of such an injunction. Of course, defendants who have wilfully attempted to profit through violation on a
confidential relationship need not be placed in as good a position as other honest competitors.

- The plaintiff is entitled to have its trade secrets protected at least until others in the trade are likely, through legitimate business procedures, to have become aware of these secrets. And even then the defendants should not be permitted a competitive advantage from their avoidance of the normal costs of invention and duplication. Where the defendants have saved substantial expense by improperly using confidential information in creating their product, the ultimate cessation of an injunctive order might well be conditioned on their payment of an appropriate sum to the plaintiff.139

In summary, the court in the Analogic case wanted hard factual evidence against which to test the reasonableness of the injunction. Canadian courts require the same factual depth in dealing with the reasonableness of duration and geographic limitations. Once the evidence is provided, then the courts will allow an adequate level of protection. An outright prohibition of competition has even been granted by both the Canadian and English courts, once the test of reasonableness has been met.140

F. The Public Interest and Employment Restraints

A post employment restraint can be attacked on the grounds that the public interest will be harmed by its enforcement. To prove harm to the public interest, a covenantee must first identify the extent of this vague term. Unfortunately for such a litigant, the case law on this point is rather unsettled. Cheshire & Fifoot admits to a certain confusion by stating that "The concept of public interest admits of no precise definition, and is not surprising that at times it has been allowed a latitude which it is difficult to defend."141
The case law that defines the public interest divides into two general streams of authority. Both lines of cases acknowledge that a theoretical difference may exist between what is reasonable between the parties and what may be reasonable in the public interest. The real dividing argument arises over whether the court should properly consider economic and social evidence as defining the public interest.

A trio of cases represents the more restrictive view of the public interest. In Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd., Lord Pearce observed that the separate tests of reasonableness might be merged.

There is not, as some cases seem to suggest, a separation between what is reasonable on grounds of public policy and what is reasonable as between the parties. There is one broad question: is it in the interests of the community that this restraint should as between the parties, be held to be reasonable and enforceable?

This limited view of the element of public interest was followed by the statements of Ungoed-Thomas, J. in Texaco Ltd. v. Mulberry Filling Station Ltd. But what is meant by reasonableness with reference to the interests of the public? It is part of the doctrine of restraint of trade which is based on and directed to securing the liberty of the subject and not the utmost economic advantage. It is part of the doctrine of the common law and not of economics. So it must, of course, refer to interests as recognizable and recognized by law. But if it refers to the interests of the public at large, it might not only involve balancing a mass of conflicting economic, social and other interests which a court of law might be ill-adapted to achieve; but, more important, interests of the public at large would lack sufficiently specific formulation to be capable of judicial as contrasted with unregulated personal decision and application - a decision varying as Lord Eldon LC put it, like the length of the chancellor's foot.
The decision continued by observing:

If my analysis and approach are correct, unreasonableness in the interests of the public refers to the interests of the public as recognised in a principle or proposition of law and not the interests of the public at large. The questions which such unreasonableness raises would thus not be whether the restraint might be less in a different organization of industry or society or whether the abolition of the restraint might lead to a different organization of industry or society, and thus, on balance of many considerations, to the economic or social advantage of the country, but whether the restraint is in fact in our industry and society as at present organized, and with reference to which our law operates, unreasonable in the public interest as recognised and formulated in such principle or proposition of law.145

Both the Esso case and the statements of Ungood-Thomas J. were applied by the Ontario Court of Appeal in Stephens v. Gulf Oil Canada Ltd.146 Thus, the Court of Appeal tested possible injury to the public interest against the basic proposition underlying the restraint of trade doctrine i.e., that all men have the right to trade freely subject to reasonable restraints to protect other proprietary interests.147

Specifically, the Court of Appeal was rejecting an economics oriented approach to restraint of trade that was adopted by the trial judge.148 Henry J. in the lower court, had accepted economic evidence as to the industry wide impact of dealer agreements. He therefore came to the conclusion that such agreements were individually contrary to the public interest; since the collective effect of many of these agreements would be anti-competitive.149 The Court of Appeal dealt with Henry J.'s approach by quoting a statement from Cheshire and Fifoot that "Reason and justice would seem to prescribe that an agreement, reasonable
between the parties, should not be upset for some fancied and problematical injury to the public welfare."\(^{150}\)

In summary, this trilogy of cases lead one legal commentator to observe that the reasonableness of a restrictive covenant was no longer subject to two separate tests. The conclusion was that "the distinctions between what is reasonable between the parties and what is reasonable on the grounds of public policy is falling into disuse."\(^{151}\) The Stephens decision even aroused some unusually impassioned statements of support. Fridman strongly applauded the decision of the Court of Appeal as avoiding "the walk along the slippery path that eventually leads to the negation of law and the abduction of the rule of law."\(^{152}\)

The second line of authority on the limits of the public interest takes a more expansive view of the court's role. Following Henry J.'s approach in the Stephen's case,\(^{153}\) these authorities argue that injury to the public interest can be tested against solid economic and social evidence. The test should not be limited to any ill-effects already expressed in a proposition of law.

The highest Canadian authority to date is the Ontario Court of Appeal in Tank Lining Corp. v. Dunlop Industrial Ltd.\(^{154}\) In a unanimous decision of the three member Court, Blair J.A. disapproved of the restrictive approach and made the following forceful, although obiter dicta comments:

Nevertheless, I cannot refrain from expressing my concern that restricting consideration of the public interest to economic and social effects which in some fashion have acquired the status of legal dogmas, might result in the doctrine losing its utility as a valuable instrument for adjusting this branch of the law to changing economic and social conditions.
and subsequently stated that:

It seems to me that situations can be imagined where a reciprocal restrictive covenant resulting in the complete termination of a business enterprise might produce economic and social effects demonstrably harmful to the public interest. The cessation of business might, for example, deprive the nation or a region of an essential industry, an important source of wealth and employment or vital technology. Such harmful effects would be difficult to ignore even though they might not be included in those expressed in propositions of law which tend to be concerned with abhorrence of monopoly or the advancement of freedom to trade and competition.\(^{155}\)

As Blair J.A. noted in his comments, the Supreme Court of Canada has not as yet dealt specifically with the limits of the public interest. In 1981, in the *Doerner* case, McIntyre J., ruled that the conduct of the covenantee was a relevant matter that affected the public interest.\(^{156}\) However, the covenantor was alleging that the covenantee was engaging in corrupt and monopolistic practices. Such conduct would have been in breach of the principles of the law already expressed in statute.

Other lower court decisions on restrictive covenants appear to have considered economic and social benefit arguments. In *Sherk v. Horwitz*, the Ontario High Court not only looked at the number of obstetricians practicing in an area, but held that disrupting the patients' relationship with a doctor was injurious to the public interest.\(^{157}\) In *Baker v. Lintott*, the Alberta Court of Appeal allowed an appeal to enforce a restrictive covenant since no harm to the public interest in a reasonable level of choice in the delivery of health care services had been demonstrated.\(^{158}\) The British Columbia Supreme Court similarly recognized
a wider public interest when it refused to compel a drug store to close where it was the sole source of supply for 2000 local residents.159

A similar judicial trend to a more liberal acceptance of economic evidence is taking place in cases under the Combines Investigation Act.160 The Supreme Court of Canada has expressed its acceptance of economic evidence to prove detriment to the public interest.161 The Supreme Court ruling is in clear contrast to the trial judge who expressed willingness to ignore any economic implications:

Considering, first, "The market structure" - I believe myself on safe ground by stating that our Canadian decisions "have consistently refused to be diverted by economic or theoretical arguments about when a market begins or ends and find the existence of a market from the particular facts of a case," as submitted by the Crown, in its brief.162

Two other recent cases under the Act indicate that the courts are increasingly willing to consider expert evidence on the appropriate economic principles to be applied. In the decision to convict Hoffman-La Roche Inc. of predatory pricing contrary to sec. 34 (1) (c), Linden J. of the Ontario High Court was interpreting the meaning of "unreasonably low prices" and stated, "Economic theory cannot control the legal determination of reasonableness, but it is certainly relevant." As a consequence the court in the decision referred to the evidence of two economic experts and subsequently selected the more flexible approach advocated by one of the experts.163 An even more open attitude to economic evidence on the part of both the court and the R.T.P.C. is provided by the interlocutory application in Bombardier Ltd. v. Restrictive Trade Practices Commission. This case discussed the admissability of expert economic evidence and the production of the expert's reports. Cattanach J. noted that the key issue was whether the
exclusive dealing adopted by Bombardier lessened or was likely to lessen
competition substantially in a market and then commented:

I would expect that whether competition has been lessened
is a fact and as such concrete evidence could be adduced to
so prove if it had occurred. However, whether exclusive
dealing is likely to substantially lessen competition is a
future occurrence and can only be established to be likely
as the inexorable consequence of sound and irrefutably
established economic principles.164

It must be admitted that cases that apply the criminal law provisions
of the Combines Investigations Act are not binding precedents for civil
actions under the doctrine of restraint of trade. However, it is
suggested that combines legislation and the doctrine of restraint of trade
share the same roots in social policy. The more liberal approach taken by
the cases cited under the Combines Investigation Act should be persuasive
precedents for restraint of trade cases. The close relationship between
these two areas of the law was explored by Blair J.A. in Tank Lining
Corporation Ltd. v. Dunlop Industrial Products Ltd.165

It is obvious that the covenant in restraint of trade in
this case would not be likely to invite prosecution under
the Combines Investigation Act, because it does not attain
criminal proportions nor confer market dominance on the
parties. It does not follow, however, that the covenant
could not be regarded as unreasonable with reference to the
public interest under the Nordenfelt doctrine. This
recognized by s.39 [rep. & sub. ibis., s. 18(1) of the Act
which provides:

39. Except as otherwise provided in this Part,
nothing in this Part shall be construed to deprive
any person of any civil right of action.
Where any agreement clearly contravenes the Act, it will be
automatically struck down under the second branch of the
Nordenfelt test as occurred in Weidman v. Shragge, supra.
In other cases where an agreement falls short of offending
the strict criminal standards of the Act, it will still
have to face the test of the broader considerations of
public interest applicable in civil actions.

In summary, the limits of the public interest under the restraint of
trade doctrine remains a legal issue that can only be settled by the
Supreme Court of Canada. The most recent authorities appear to favour the more liberal interpretation. The doctrine might ultimately require an assessment of the effect of an employment agreement on economic and social conditions involving the public. In Heydon's words, "the doctrine may be at the threshold of one of its greatest advances."166

G. OTHER CONSIDERATIONS

1. **Onus of Proof in Litigation of Covenants:**

Well settled principles of law apply to ascertain the reasonableness of restrictive covenants. The English and Canadian authorities have adopted the same legal framework for the justification of an employment restraint. "The onus is on the party seeking to enforce the contract ... to establish that it is reasonable in the interests of the parties. The onus for establishing that it is not reasonable in the public interest is on the party opposing enforcement..."167

Similar agreement exists as to the appropriate time to judge the reasonableness of the restraint. "[T]he question of reasonableness of a covenant must be considered with reference to the time that covenant is given."168 This reference point does not entirely preclude a court from looking at developments which occurred after the formation of the contract. However, attention must be given only to facts which were reasonably in the parties' expectations. Cheshire and Fifoot cautions that

[T]he court must scrutinize the restraint as at the date when the contract was made in the light of the circumstances then existing and also in the light of what at that date might possibly happen in the future. The temptation to consider what in fact has happened by the time of the trial must be resisted, for a contract containing a restraint alleged to be excessive must be either invalid ab initio or valid ab initio.169
In the context of employment restraints, onus of proof does not operate as a strict legal burden. The covenantor's or covenantee's case is not tested against a rigid standard of proof. Instead, the rules of onus of proof really direct the parties attention to the factual evidence that will be required to either enforce or set aside the covenant. As the House of Lords originally stated in *Herbert Morris Ltd. v. Saxelby*, "[T]he onus of proving such circumstances must, of course, rest on the party alleging them. When once they are proved, it is a question of law for the decision of the judge whether they do or do not justify the restraint. There is no question of onus one way or another."170

Thus, the real burden on the covenantee is to show that circumstances are such that the court should conclude that the restraint is reasonable. The covenantor's burden is to demonstrate a context in which the court can conclude that the public interest would be harmed by the restraint.171

The covenantee's onus of proof also extends to the scope of the employer's interest being protected.172 Demonstrating that the restraint is reasonable between the parties cannot be limited to time and geographical limitations. As discussed earlier in this chapter, the employer/covenantee must prove all of the required elements of confidential information or trade secrets.173 Such proof allows the court to conclude that the employer has a legitimate interest to protect. Next, the court can determine whether the restraint only goes so far as to adequately protect the employer's interest.

Heydon argues that courts have generally applied strict standards in considering whether a covenantee holds a trade secret that is worthy of protection. This statement apparently applies on a general basis to Commonwealth courts, since the author relies on a variety of earlier
Australian, Canadian and British cases. However, this generalization only has limited value. The particular facts of each case are far more important than any rule on onus of proof. For example, in Electric Reduction Co. of Canada Ltd. v. Crane, the Ontario High Court shifted the onus of proof to the defendant covenantor. The reverse onus was adopted due to the suspicious circumstances in which the defendant received the employer's confidential information. Similarly, in Management Recruiters of Toronto v. Bagg the facts that the employee had removed a large number of files relating to job offers and prospects allowed the court to conclude that the employer had confidential information that deserved protection.

One final point on the employer's onus of proof should be mentioned. Is there a different onus of proof for express covenants than for breaches of fiduciary obligations?

This chapter has previously discussed the facts that prove the existence of confidential information and has referred to the helpful decision of Megarry V.C. in Thomas Marshall (Exports) Ltd. v. Guinle. However, does proving the existence of confidential information and the transfer of that information to the employee satisfy the employer's onus of proof? Can the employer also argue that the employee's possession of the information properly leads to the conclusion that the information will be disclosed or misused?

Many cases that make this argument deal with alleged breaches of an employee's fiduciary or implied duties and must be distinguished. As in Hivac v. Park Royal Scientific Instruments Ltd. the Courts will protect an employer against deliberate and harmful actions undertaken by employees. Such actions violate an employee's obligations of fidelity.
However, such cases are not decided on the same legal basis as the enforcement of covenants in restraint of trade. Express covenants are considered to be prima facie void because they restrict the employee's use of his own skills and personal knowledge.

Thus, in the case of *Chevron Standard Limited v. Home Oil Co. Ltd.* and *Leeson*, the court rejected the idea of a "possibility of misuse doctrine." The former employee, Leeson, possessed confidential information, but emphatically denied that he would use it for the benefit of his new employer. Since Leeson was not a trustee or director, he was not subject to the onerous duty of avoiding any engagement "which possibly may conflict with the interests of those whom he is bound to protect."

Instead, Moore J. of the Alberta Queen's affirmed that the onus of proof rested upon the former employer.

There must be more than a mere possibility of misuse to settle liability on a party. Suspicion of misuse of confidential information is insufficient - there must be real evidence. *Chevron* has not satisfied its burden of proof with respect to the matters alleged in the statement of claim.
FOOTNOTES: CHAPTER V


6. A similar reasoning was displayed by the High Court of Australia in Geraghty v. Minter (1979) 26 A.L.R. 141. The case involved the enforcement of a non-competition clause after the dissolution of a partnership. The covenanting partner had also received the rights to the goodwill of the partnership, and claimed that the non-competition clause was the only practical means of protecting the goodwill. Even though the Court noted the theoretical differences between employment and partnership restraints, the real concern was to allow a reasonable protection for the covenanting. The clause was enforced.

7. Supra, note 5 at p. 8.


13. Chapter VI reviews the injunction remedy.


15. (1938) 55 R.P.C. 21 (Chancery Div.)

16. Id., at 23.

17. Id., at 28.


19. Id., at 468.


23. Id., at 261.


27. Id.

28. Id.


34. *Supra*, note 5.


36. *Id.*


41. Culzean Inventions Ltd. v. Midwestern Broom Co. Ltd. [1984] 3 W.W.R. 11 (Sask. Q.B.) A number of U.S. cases have also considered whether licensing royalties are enforceable even after the public disclosure of the licensed trade secret. Aronson v. Quick Point Pencil Co. 440 U.S. 257 (1979) and see *Case Comment* (1978) E.I.P.R. 28.


46. Supra, note 39.


51. Id. at 622.


54. Id., at 565.

55. Lord Macnaughten's statement was not immediately accepted by the House of Lords in the Nordenfeldt decision, but was expressly adopted by the House of Lords in Mason v. Provident Clothing and Supply Company Limited [1913] A.C.724. See also the more recent application in Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd. [1968] A.C. 269, at 299-300 per Lord Reid. For an earlier Canadian authority, see Maguire v. Northland Drug Co. Ltd. Supra, note 2.


58. Id.

59. Supra, notes 57 and 58 for the four questions.
60. See Western Inventory Service Ltd. v. Sager (1983) 148 D.L.R.(3d) 434, at 439 (Ont. H.C) where Mr. Justice Krever lists 16 propositions of law applicable to the doctrine of the restraint of trade and employment restraints. No mention is made of the element of public policy.


63. Supra, note 61.

64. Supra, note 57, at 668-69.

65. Supra, note 61, at 355.


67. Id.


72. Supra, See Chapter II Section D.

73. Id.


75. Id., at 607.

77. Supra, note 66.

78. Onus of Proof under the Doctrine of Restraint of Trade is reviewed in part G of this Chapter.


80. Supra, note 26 at p. 86-87.

81. Supra, note 74.


84. Id.


88. This list was prepared by the author as part of materials for the 1985 Computers and Law Institute March 11th/12th 1985 Continuing Legal Education Society of B.C. (as yet unpublished)

89. Supra, Note 87 at 488-89. A related example is Mustad v. Doson [1963] R.P.C. 97 where the owner of information applied for a patent and disclosed it to the world. The information in the patent specification was no longer protected as confidential.


91. In Paul v. Southern Instruments [1964] R.P.C. 118, the plaintiff was able to successfully enforce obligations of secrecy against customers who leased phone answering machines.
92. **Supra.** Note 90 at 250-51.

93. **Id.**

94. **Supra.** Chapter III at Fn. 5 for relevant cases and recent articles.


98. **Id.**


100. **Id.** at p. 43.


102. **Id.**, at 714.

103. **Supra, Note 99 at 823 Fn. 7 referring to Gillette Co. v. Williams** 360 F. Supp. 1171 at 1176-78 (1973) D. Connecticut.

104. [1964] 3 All E.R. 731 (Ch. D.).

105. **Id.**, at 735.

106. **Id.**, at 736.


distinction between privileged knowledge and portable knowledge was accepted by the court.


112. Supra, note 90, at 249, Tasco Telephone Answering Exchange Ltd.


116. Supra, note 11.


118. Id., at 318.


121. Id., at p. 209.


123. Id.


126. [1894] A.C. 535 (H.L.) at 300-301.
130. Supra, note 42 at 68-69.
131. Supra, note 26 at 344-45.
134. Id.
136. 358 N.E. 2d 804 (1976), Supreme Judicial Court of Mass.
137. Id., at 806-07.
138. Id.
139. Id., at p. 805-08.
141. Supra, note 39 at 358.
142. The public interest in confidential information is also being explored in other areas than the doctrine of restraint of trade. For example, the public interest has been recognized as a defence in a breach of confidence actions: Fraser v. Evans [1969] 1 All E.R. 8; Hubbard v. Vosper [1972] 1 All E.R. 1023; Initial Services Ltd. v. Putterill [1968] 1 QB 396; The public interest also has resulted in a different legal treatment of government secrets rather than

144. [1972] 1 All E.R. 513.
145. Id., at 526-27.
147. Id., at 213.
149. Id., at 200.
150. Supra, note 39 at 213. See also Macaulay v. Schroedor Music Publishing Co. Ltd. [1974] 3 All E.R. 616 (H.L) at 626 where Lord Diplock degraded the importance of economic theory and stressed the element of fairness between the parties.
153. Supra, note 146.
155. Id., at 674.
165. Supra, note 57 at 671.
169. Supra, note 39 at 359.
There is a lack of case authority dealing with this point, but the logic of the conclusion is supported by Heydon, J. D. "Recent Developments in Restraint of Trade" (1975) 21 McGill Law Journal, 325 supra, note 139, at 44. Brait, Richard A. "The Use of Restrictive Covenants in the Employment Contract" (1981) 6 Queens Law Journal 414, at 437-38.


Chapter IV dealt with Implied and Fiduciary Obligations.


Id.


Id.
VI THE CRITICAL REMEDIES FOR BREACH OF AN EMPLOYEE'S OBLIGATIONS

As discussed in the previous chapters, the obligations of a skilled employee in the computer industry to his employer arise from separate categories of implied, fiduciary and express obligations. The remedies that are available to deal with a breach of an obligation depend primarily upon the source of the obligation. Thus, breach of the express terms of an employment contract lead to the well defined principles of damages set out in Hadley v. Baxendale1 and subsequent decisions.2 Thus, an employee who violates an express restrictive covenant will be liable in damages for all the losses that were reasonably foreseeable to the parties at the formation of the contract. Where the implied obligations are considered to be implied terms of the contract, the same rules on contractual damages will apply.3

The British Columbia Court of Appeal has similarly stated that damages for breach of an employee's fiduciary obligations are to be assessed on the same basis as any other breach of contract.4 However, there are certain remedial issues that are critical for an employer in the computer industry. First, what damages can be awarded against a third party who participates in or benefits from an employee's breach of confidence? Secondly, what are the appropriate principles for an interlocutory injunction to restrain an employee from breaches of a restrictive covenant? Thirdly, can the courts grant exemplary or punitive damages against an employee for a breach of employment obligations?

These three remedial questions have been selected for their great importance to the particular circumstances of the computer industry. Their relevance will be explained in each specific section.
The assumption that these issues are of a particularly critical nature to the industry does not mean that a variety of other remedies are not relevant. Remedies such as Mareva injunctions, permanent injunctions, constructive trusts, Anton Piller orders, accounting for profits and delivery up are all potentially applicable to redress the losses suffered by employers in the computer industry. However the very number and complexity of these possible remedies has lead to a concentration on the three most critical remedial issues:

1. **Damage Awards against a Third Party Who Benefits From an Employee's Breach of Confidence**

Remedies against third party outsiders are crucial for an employer in the computer industry. An employee may breach express covenants of confidentiality by appropriating software and then selling the program to a third party competitor. If the employee then disappears, the normal contractual remedies of damages or injunction based upon the breach of contractual obligations are irrelevant. The employer's concern is to either prevent the competitor's use of the software via an injunction, or else to claim compensation in damages if the competitor has already made successful use of the software. If it is assumed that the competitor's actions amount to a breach of an obligation of confidence, then what principles of damages apply to such a breach?

First, it appears that the courts, in the absence of express contract or property rights, are exercising the concurrent jurisdiction of equity in restraining breaches of confidence. This was also the conclusion of the Law Commission's report on Breach of Confidence after reviewing cases such as *Prince Albert v. Strange* and *Morrison v. Moat*. 
If confidential information can invoke the purely equitable powers of the courts, then the remedies for breach of confidence will not be always subject to common law limitations. Instead, equity can impose its own substantive jurisdiction to protect information in those situations where the absence of contract or property rights has removed the case from the common law. Fullagar J. of the Supreme Court of Victoria expressed this concept in a recent trade secret case as follows:

It must also be constantly borne in mind that equity acts in personam upon the defendant, that it is only unconscionable conduct that equity will restrain or visit with its other remedies, and that equity only extends any remedy at all where it is satisfied both that it is just in all the circumstances to extend it and that there are no remedies available at common law (e.g., by reason of property at common law or of some common law contract) which are in all the circumstances adequate.17

Strong Canadian authority exists for the court's right to award equitable damages. This authority upholds the view that breach of confidence is an illustration of equity acting in its substantive capacity. In Elsley v. J.G. Collins Insurance Agencies Ltd., a unanimous decision of the Supreme Court of Canada, the principle is given that: "a plaintiff may have a right to damages in equity in addition to an injunction if he can establish his entitlement under the appropriate equitable considerations."18 Dickson J. (as he then was) traced the Court's power to award damages in equity in the province of Ontario back to the Lord Cairns' Act of 1858. Section 21 of this legislation provided:

Where the court has jurisdiction to entertain an application for an injunction against a breach of a covenant, contract or agreement, or against the commission or continuance of a wrongful act, or for the specific performance of a covenant, contract or
agreement, the court may award damages to the party injured either in addition to or in substitution for the injunction or specific performance, and the damages may be ascertained in such manner as the court directs, or the court may grant such other relief as is considered just.19

The British Columbia Supreme Court has considered whether the Lord Cairns Act, 1858, is part of the law of British Columbia. In Arbutus Park Estates v. Fuller Toy J. decided that the Lord Cairns' Act 1858 (Imp) c.27, was adopted in British Columbia by virtue of the English Law Act, R.S.B.C. 1960, Chapter 129.20 The current statutory authority is now section 2 of the Law and Equity Act chap. 224 R.S.B.C. 1979. As a result of these authorities, the courts in British Columbia have the power to award equitable damages. Authority from other jurisdictions supports this conclusion on the effect of the Lord Cairns' Act.20a

Having concluded that our courts have the power to grant damages in a purely equitable capacity, what principles should be followed in calculating the award? Fortunately, the Supreme Court of Canada has presented some flexible guidelines to assist the lower courts. In the unanimous decision in Elsley v. J.G. Collins Insurance Agencies Ltd, Dickson J. suggested that usually the common law principles could be followed to determine equitable damages:

It will generally be appropriate to adopt in equity rules similar to those applicable at law: Spry, Equitable Remedies '1971', at page 552-554. This is so not because the court is obliged to apply analogous legal criteria, but because the amount of compensation which would satisfy the loss suffered, and which the court considers just and equitable to be paid, usually happens to be equivalent to the amount of legal damages which would be appropriate.21

However, Mr. Justice Dickson did not want the recommended use of the common law damage rules to be interpreted as a limitation on the substantive power of equity in a breach of confidence action.
Accordingly, the court carefully pointed out that:

The award is still governed, however, by general equitable considerations which would not apply if the plaintiff were seeking damages at law rather than in equity. These considerations might serve, for example, to reduce the amount due to such factors as delay or acquiescence.22

However, the general guidelines noted above still leave many damage related questions unanswered. Lord Denning's decision in Seager v. Copydex23 points out the theoretical and pragmatic confusion that a court can create. The case involved a plaintiff who disclosed confidential information relating to an invention to the defendant's officers during the course of negotiating a market contract. The negotiations ended without the defendant's entering into a contract with the plaintiff. However, the defendant then used the plaintiff's information as the basis upon which to develop and market its own product. The plaintiff was successful and received a lump sum damage award from the Court. Lord Denning based the protection afforded the plaintiff upon "the broad principle of equity that he who has received information in confidence shall not take unfair advantage of it. He must not make use of it to the prejudice of him who gave it without obtaining his consent."24

After deciding that the plaintiff was protected by equity, the judgement turned to the calculation of the plaintiff's damages. Lord Denning's unfortunate choice was to view the unauthorized use of confidential information as analogous to the tort of conversion.

Since the conversion analogy meant that the plaintiff had been deprived of his property, the logical remedy was then either to return the property to the plaintiff or to compel the defendant to pay a royalty for
its use. Since the defendants had used the plaintiff's information to manufacture their own product, Lord Denning awarded damages calculated as a royalty capitalized into a lump sum award. To complete the analogy with the tort of conversion, Lord Denning concluded that the damage award "would be regarded as a real outright purchase of the confidential information". In other words, after the payment of the damage award, the defendants became the new owners of the information.

Fortunately, Canadian courts have not as yet followed this portion of Denning's judgment. The analogy to the tort of conversion is quite unsatisfactory as the legal basis for damages involving confidentiality and the misappropriation of software. Lord Denning's approach assumes that information is indivisible, like a chattel, and can only belong to one owner. However, information such as software can be easily duplicated and be possessed by multiple owners. If Lord Denning's reasoning was applied to a software misappropriation, the plaintiff would theoretically be barred from using the software after final judgment. Having paid the damages, the defendant would be the new owner.

Such a result also puts the plaintiff in an illogical position as to the future use of the software. A basic premise of a trade secret is that it ceases to exist as soon as the information enters the public domain. Mass marketing of the software by the defendant could effectively end the secret. However, the plaintiff would then be the only person prohibited from using the software.

Another objection to the tortious analogy is that it implies a system of compulsory licensing or compulsory transfer of information. The Seager v. Copydex damage award forced the original holder of the confidential information to sell the information at market price to an
unlawful appropriator. The practical consequences of such a court judgement would shock the software industry. In effect, a software vendor would be giving up an immediate market edge for a future lump sum damage award.

These theoretical and pragmatic problems lead the Law Commission in the United Kingdom to recommend a new statutory tort for breach of confidence. In part, the recommendation was based upon their analysis of the "uncertainties or inadequacies" in the existing remedy of damages. A similar conclusion was recently put forward by the Institute of Law Research and Reform in Alberta. In its February, 1984 report on Protection of Trade Secrets, the Institute referred to the uncertainties caused by the difference (if any) between equitable and legal damages. In a summary of the existing law, the Institute stated "the Courts have not firmly resolved how far liability can or should be imposed upon third party recipients of the confidential information", and then concluded that "the remedial problems which this cause of action creates make it very difficult to advise clients with any real confidence". The Institute proposes two alternative draft bills to provide statutory protection against the non-authorized appropriation of trade secrets. In effect, the Institute is recommending that unauthorized recipients of a trade secret should be subject to a statutory tort action.

2. Interlocutory Injunctions to Restrain Breaches of a Restrictive Covenant

The interlocutory injunction ranks as the most important remedy to protect a software trade secret against ex-employees. Given the intense competition in the software marketplace and the speed with which a software product becomes outdated, strict secrecy during product development must be maintained. The interlocutory injunction is the legal
remedy that best preserves an employer's desire to be first into the market with a new product.

American authorities support the view that widespread marketing of software does not necessarily destroy the trade secret by reason of publication. Provided that customers receive the software under obligations of confidence (as in restrictive licensing agreements), the trade secret is preserved.31 Given the widespread distribution of software, an interlocutory injunction must be viewed as the most effective remedy to deal with an outright instance of software piracy. Any misappropriation could quickly lead to the marketing of a vendor/employer's software in a thinly disguised format. The employer's primary concern will be to stop the erosion of his market as soon as possible via the injunction remedy.

A strong monetary disincentive exists for an employer considering a trial and a damage award instead of the injunction remedy. Even if the former employees have exigible assets in the jurisdiction, the damage awards for breach of contract only provide a theoretical recoupment of loss. A successful plaintiff must still pay for the expense of litigation. In particular, court costs are increasingly inadequate to offset legal fees. The editor of the Advocate recently observed that court costs today in B.C. only recover approximately 10%-20% of legal fees connected with litigation.32

The backlog in our civil courts combines with the expense of litigation to increase the importance of interlocutory relief. Civil cases in British Columbia are currently experiencing delays of between 12 to 16 months from the date the action is set down for trial to the actual court date. These delays do not include the prior time involved in the
initial preparation, pleadings and examinations for discovery. The short product life of software, the expense of litigation and court delays mean that an interlocutory injunction is often determinative of the parties' rights.

Given the importance of the interlocutory injunction remedy for an employer in the computer industry, what are the grounds upon which Canadian courts will grant this relief? This question can only be answered by placing the injunction remedy in a historical perspective.

An injunction was originally issued by a Court of Equity to protect an equitable right against a clearly conflicting legal right or title, or else in a case where the legal rights and remedies available to a party were clearly inadequate.

The role of the interlocutory injunction was to preserve the status quo between the parties prior to the actual trial of the issues. This limited view of the function of an interlocutory injunction reflected several factors. Firstly, the volume of litigation was relatively low so that the Chancery Division could deal with any action without undue delay. Secondly, the disputes were mainly over private property. The cases were usually unaffected by public policy issues such as the restraint of trade. An interlocutory injunction was therefore not critically important to the parties. The courts accordingly demanded a high standard of proof for the granting of an interlocutory injunction:

1) The plaintiff had to demonstrate a strong prima facie case (on the balance of probabilities) that both the right existed and that it had been infringed;

2) The plaintiff then had to demonstrate irreparable damage meaning that monetary damages obtained at trial would not adequately compensate him;
3) The plaintiff finally had to show that the balance of convenience favoured the granting of the injunction.35

The high volumes of litigation experienced by the courts of Chancery in the 1960s and 1970s pointed out the rigidity and inadequacy of these injunction requirements. Neither the litigants nor the courts could afford the delays and high costs associated with the sheer numbers of what were called mini-trials by affidavit. Also, defining injunctions as a private property remedy left the courts ill-equipped to deal with issues of public and economic importance.36

In 1975 the House of Lords decision in American Cyanamid Company v. Ethicon Ltd.37 sought to establish a speedier and more effective injunction framework. By establishing a lower threshold of proof for the granting of injunctions, the court tried to avoid the then existing process which amounted to a miniature trial. Lord Diplock noted that courts were in effect trying cases at an early stage "on evidential material different from that on which the actual trial will be conducted".38

To reduce the overloading of the interlocutory process, the House of Lords held that only two factors need be considered with regard to a plaintiff's injunction application. The court should determine first whether there is a serious issue to be tried, meaning that the plaintiff's case is not frivolous or vexatious. Once this initial threshold test is passed, then the court should look at the balance of convenience that exists between the parties.39

The second factor of balance of convenience was related to an examination of the adequacy of damages as a remedy for both parties. The House of Lords emphasized that the granting of an interlocutory injunction
is normally accompanied by the plaintiff's cross-undertaking to pay
 damages. Such an undertaking will be invoked if the defendant suffers
 loss by reason of the improper granting of the injunction. (The B.C.
 Supreme Court Rules currently sets forth the same obligation for an
 injunction applicant at Rule 45(6).)

 The House of Lords did not emphasize the plaintiff's damage
 undertaking simply to protect the defendant. Rather, the emphasis was a
 clear attempt to liberalize the injunction remedy and improve a
 plaintiff's chances of obtaining relief. As Lord Diplock stated in the
 unanimous decision:

 If, on the other hand, damages would not provide an
 adequate remedy for the plaintiff in the event of his
 succeeding at the trial, the court should then consider
 whether, on the contrary hypothesis that the defendant
 were to succeed at the trial in establishing his right
to do that which was sought to be enjoined, he would be
 adequately compensated under the plaintiff's under-
taking as to damages for the loss he would have
 sustained by being prevented from doing so between the
 time of the application and the time of the trial. If
 damages in the measure recoverable under such an under-
taking would be an adequate remedy and the plaintiff
 would be in a financial position to pay them, there
 would be no reason upon this ground to refuse an
 interlocutory injunction.40

 If doubt exists about the adequacy of damages as a remedy for either
 or both of the parties, then the concern should be for the "balance of
 convenience" between the parties.40a In this way, the House of Lords
directed future courts to consider any serious public or economic factor
which affected either of the parties. For example, in the American
Cyanamid decision, the House of Lords considered the relationship between
the injunction remedy and the existence of goodwill in the product
market. The case involved a patent dispute and the defendant's proposed
introduction of a type of medical suture into British hospitals. The court noted that the Ethicon sutures were not yet on the market. Therefore no factories would be closed and no workers laid off if an interlocutory injunction was granted. On the contrary, to allow the sutures to be introduced by the defendant, only to have a permanent injunction granted at the end of the trial would seriously harm the plaintiff's goodwill. Resentment would be directed at the successful plaintiff by those doctors who had become accustomed to using the Ethicon sutures.41 Thus the plaintiff's potential loss of market reputation was recognized.

This second element of balance of convenience initially appears to answer many of the previously discussed concerns of an employer in the computer industry. Software misappropriation by an employee or an outsider can be countered by a speedy effective remedy to preserve market position. The unfortunate truth is that the courts in both the United Kingdom and Canada have not widely accepted the American Cyanamid framework. In the United Kingdom one of the major difficulties has been the judicial realization that the interlocutory injunctions application is normally the determinative proceeding where confidential information is involved. This awareness leads to the courts to consider the case much more carefully and to sidestep the lower burden of proof applied by American Cyanamid.42

What position have Canadian courts taken in response to the two-part test established by the American Cyanamid decision? To date the more flexible approach has not been widely applied to restrictive employment covenants. There has not yet been an authoritative Supreme Court of Canada decision or Court of Appeal case that has either expressly accepted
or disapproved of the American Cyanamid test with reference to employment contracts. The Ontario courts at the trial level were initially unsure about adopting the lower threshold, even for a franchise case, but subsequent decisions have rejected the House of Lord's propositions as inappropriate for restraining former employees. In *Drake International Ltd. v. Wortmann*, a three member branch of the Ontario High Court of Justice distinguished two contrary earlier decisions and then stated:

Whatever may be the situation when patents are in issue or the protection of undoubted trade or business secrets, we are not prepared to say that in a case where a restrictive covenant in an employment contract is at issue, the relatively modest standard adopted in American Cyanamid is appropriate. The Court turns its face against such a covenant in an employment contract, and it is incumbent upon the plaintiff to show that there is at least a prima facie case that it will be successful at trial before the Court will grant its aid by issuing an interim or temporary injunction. This, in our view, the plaintiff has not done with respect to the primary point made before us, that of the existence of a proprietary interest to be damaged.

The same views were expressed in *Control Ltd. v. Bodi Chemicals Ltd.* by Goodman J. and thereafter accepted in *Nelson Burns & Co. v. Gratham Industries Ltd.* by Eberle J. of the Ontario High Court:

If the traditional onus placed on an applicant for interlocutory relief to establish a strong prima facie case is a more stringent requirement than the satisfaction by such an applicant of the test which has apparently been imposed by the American Cyanamid case, namely, that there is a substantial issue to be tried, then I am of the opinion that the more stringent standard of proof should be required in an application for an interlocutory injunction restraining a former employee from committing a breach of a restrictive covenant contained in an employment contract.
Although the Ontario Court of Appeal has not specifically stated its position, there has been one indication of support for the strong prima facie position. In *Chitel v. Rothbart*, the court considered the standard of proof to be applied to an interlocutory application for a Mareva injunction. Before rejecting the lower threshold of proof for Mareva injunctions in special circumstances, the court stated that the interlocutory injunction "remedy must remain flexible and that the *American Cyanamid* test may not be a suitable test in all situations".

The conclusion reached by the Ontario trial courts seems to be that the *American Cyanamid* test is not suitable for interlocutory injunctions in employment contracts. In effect, there has been a refusal to lower the employer's burden in an injunction application. The restriction appears to come from the traditional policy statements regarding employment restraints. Thus the trial courts refer to the "imbalance of bargaining power" in favor of the employer and to the "more stringent test in the enforcement of restrictive covenants" in employment contracts. The underlying fear is that the *American Cyanamid* test would allow the employer to accomplish at an interlocutory stage what he will not be able to achieve at trial.

The *American Cyanamid* test has received a mixed and uncertain reaction from the B.C. trial courts insofar as the lower threshold applies to employment restraints. Part of the confusion resulted from the initial reported Chambers decision to have considered *American Cyanamid*. In *Lindsay v. Lindsay*, Craig J. (as he than was) initially applied Lord Diplock's wording of "a serious question to be tried" rather than a "strong prima facie case". However, Craig J. then used the judgement of Lord Cairns in *Doherty v. Allman* for the principle that "irreparable
harm need not be proved to enforce a negative covenant by way of injunction." Lord Cairns had been dealing with difficulties of ordering the specific performance of a personal services contract. Although the court could not enforce an order of specific performance, the court would issue an injunction against the employee where the effect was limited to enforcing a restrictive covenant. However, the words of Lord Cairns contemplated a standard of proof for the employer that would be even lower than the American Cyanamid test:

My Lords, if there had been a negative covenant, I apprehend, according to well-settled practice, a Court of Equity would have had no discretion to exercise. If parties, for valuable consideration, with their eyes open, contract that a particular thing shall not be done, all that a Court of Equity has to do is to say, by way of injunction, that which the parties have already said by way of covenant, that the thing shall not be done; and in such case the injunction does nothing more than give the sanction of the process of the Court to that which already is the contract between the parties. It is not then a question of the balance of convenience or inconvenience or of the amount of damage or injury—it is the specific performance, by the Court, of that negative bargain which the parties have made, with their eyes open, between themselves.

Subsequent B.C. cases have tried to distinguish Lindsay v. Lindsay as a non-employment case, or have rejected the statement of Lord Cairns on general policy grounds. The specific objection was made that "To apply the statement in all its force would deprive the Court of discretion," with the reminder that "[T]he granting of an injunction must always remain a matter of the Court's discretion," Thus, the Supreme Court in B.C. eventually rejected part of Craig J.'s earlier decision in Lindsay v. Lindsay.
The difficulty in dealing with the *Doherty v. Allman* deviation obscured and delayed the acceptance of the American Cyanamid test for employment injunctions. However, the B.C. trial court decisions do indicate an acceptance of the lower threshold for an interlocutory application to enforce a restrictive covenant.62 Two more recent decisions confirm this conclusion. In *Andico Manufacturing Ltd. et al. v. Gary Bombay et al.*,63 MacEachern C.J. followed an earlier judgement of Bouck J,64 and granted an interlocutory injunction based on the American Cyanamid two-part test. The plaintiff was a former employer who was seeking the injunction to enforce a non-competition clause granted by an ex-employee. In a subsequent decision that was not related to employment issues, the British Columbia Court of Appeal approved the "useful summary" of the American Cyanamid principles given by Bouck J.65

In summary, there have not been any authoritative decisions by the Supreme Court of Canada nor by the appeal courts in Ontario and B.C.66 In the absence of such guidance, the trial courts in these two provinces appear to have arrived at different conclusions on the American Cyanamid test with respect to employment restraints. It is suggested that the Ontario court's rejection of the lower threshold for injunctive relief is overly cautious. Modern employees have the advantages of higher education, job mobility and collective bargaining to adjust for the feared imbalance in negotiating power between themselves and their employers.

At the same time, an employer in the computer industry cannot adequately be protected by the trial process and the other legal remedies. The lengthy delays prior to trial limit the alternative remedy to damages. Moreover, even if a damage award is granted against an individual misappropriator, the average employee will not have sufficient
assets to satisfy a large damage award. The traditional position on the granting of injunctions also limits the court's ability to consider the larger economic or public issues involved. If the balance of convenience is used as the second part of the test instead of irreparable damage, the court can focus on the wider social and financial concerns of the parties. In this way, goodwill in the marketplace and the closure or non-closure of manufacturing plants became relevant issues for the House of Lords in the original decision.  

In conclusion, maintaining the more restrictive approach to interlocutory injunctions presents a serious weakness for the legal protection of confidential information in the computer industry. A recent comment by Hull summarizes the remedial problem that faces an employer who passes on trade secrets to skilled employees.

One area where injunctive relief has failed to give effective protection to litigants is in the field of trade secrets, in particular where the relevant information is part public, part secret, or where it concerns a field of technology where technical advance rapidly degrades novelty or confidentiality and brings the information into the public domain.

3. Award of Punitive Damages against An Employee for Breach of Employment Obligations:

In summary, this section reviews an employer's right to claim punitive damages in the event that an employee breaches implied contractual obligations, fiduciary obligations, or express contractual covenants. Initially, this section will discuss the background to punitive or exemplary damage awards in Canada, and explain why this type of damage award of particular interest to an employer in the computer industry.

Although the award is generally associated with a tort action, punitive damages are not granted to compensate an injured party for
tortious loss. Instead punitive or exemplary damages are an additional award to an injured plaintiff that goes beyond the compensatory function of tort law. In this sense, the award operates as a fine that is levied upon the defendant and paid to the plaintiff.

The correct position is that aggravated damage or damages are compensatory to the plaintiff and are to be distinguished from exemplary or punitive damage or damages which are awarded where it is proper to punish and deter by the example of such punishment (or penalty), like-minded individuals.68a

The importance of such an award to computer industry employer lies in its deterrent value and in its extra financial contribution to offset the high costs of litigation.

Different principles govern the awarding of punitive damages in the two jurisdictions of the United Kingdom and Canada. In England and Wales, damages in addition to compensation (i.e., punitive or exemplary), are granted in accordance with the principles set out in Rookes v. Barnard.69 Such damages must be related "either to oppressive, arbitrary or unconstitutional action by servants of the government or to conduct by the defendant calculated to give him a profit likely to exceed the compensation payable to the plaintiff".70 A third category noted by Rookes v. Barnard is an award of punitive damages expressly authorized by statute.71

Only the second category noted above is relevant to employment and rights to information. Obviously, the precise language used severely restricts the basis for the award, and will only result in damages being granted in extreme cases.

Canadian courts have rejected the limitations imposed upon punitive damages by Rookes v. Barnard.72 Rather than being restricted to precise categories, the awarding of punitive damages is reserved for those "cases where the conduct of the defendant has been such as to merit condemnation
Exemplary or aggravated damages are not, broadly speaking, awarded in actions for breach of contract, since damages for breach of contract are in the nature of compensation, and the motives and conduct of the defendant are not considered relevant to the assignment of damages. The action for breach of promise of marriage and an action upon a contract against a banker for wrongfully refusing to pay his customers' cheques constitute exceptions to this rule. Generally, however, such damages may be awarded in actions of tort such as assault, trespass, negligence, nuisance, libel, slander, seduction, malicious prosecution and false imprisonment. If, in addition to committing the wrongful act, the defendant's conduct is 'high-handed, malicious, conduct showing a contempt of the plaintiff's rights, or disregarding every principle which actuates the conduct of a gentleman', (to quote a few examples taken from the authorities) his conduct is an element to be considered as a circumstance to aggravation which may, depending upon its extent or degree, justify an award to the injured plaintiff in addition to the actual pecuniary loss which he has sustained. I do not think that it can be stated with any precision what may be classed as aggravating circumstances but malice, wantonness, insult and persistent repetition have always been regarded as elements which might be taken into account.

How does the concept of punitive damages apply to skilled employees in the computer industry? In the United States, the courts use such damage awards to prevent and punish the misappropriation of trade secrets, and accordingly grant sizeable punitive damage amounts.

There are many authorities that advance the legal principle that Canadian courts will not award punitive damages for breach of contract. However, this limitation upon a court's discretion to award punitive damages is being increasingly questioned at the trial court level in Ontario. In Brown v. Waterloo Regional Board of Commissioners of Police Linden J. reviewed a number of recent decisions and made the following obiter statement:
"Although the general principal that punitive damages are not awarded for breach of contract survives, there is no requirement that the general principle be followed invariably. Certainly in the vast majority of situations of contract breach, there would be no possible issue of punitive damages arising. However, just as our courts have recognized the utility of awards for damages for mental suffering caused by breach of contract in appropriate circumstances, so too should punitive damages be allowed where the facts demand that they be awarded."

and then continued:

Consequently, I conclude that it is not beyond the power of this court to award punitive damages in those rare situations where a contract has been breached in a high-handed, shocking and arrogant fashion so as to demand condemnation by the court as a deterrent.

It should be noted that the British Columbia Supreme Court has recently followed the more restrictive view of the punitive damage award. In Vorvis v. I.C.B.C., MacFarlane J. found the existence of a breach of contract which justified a punitive award, but ruled that the plaintiff could only be compensated for his financial loss.

In summary, a decision of the Supreme Court of Canada will be required to clarify the existing confusion. Until that time the skilled employee who only breaches the express obligations of his employment agreement theoretically does not have to fear an exemplary damage award. However, such an employee should not feel too safe. If the employee's conduct invites condemnation, then the courts have been willing to administer the punishment. In a number of decisions, the courts have relied upon a breach of fiduciary or implied obligations as the basis for a punitive or exemplary damages award.

In Schauenburg Industries Ltd. v. Borowski, punitive damages of $25,000 were awarded against an ex-employee/general manager. The award appears to have been based upon a breach of fiduciary duties. The defendant employee had infringed his former employer's copyright and
misused confidential information. The exemplary damages were justified by
the defendant's "flagrant behaviour and a callous disregard for the rights
of his employer in breaching his fiduciary and contractual duties and in
infringing copyright." The Schauenburg case and G.E. Cox Ltd. v.
Adams, therefore indicate that punitive damages can be awarded for
Mountjoy, agreed with this logic by emphasizing that fiduciary duties
"transcended the severance of the employer-employee relationship" and
thereby allowed the court to consider punitive damages.

Other recent Canadian decisions have either considered or awarded
punitive damages against a non-fiduciary former employee. These cases
appear to rely upon the implied obligations of an employee to respect an
employer's trade secrets and confidential information. In Investors
Syndicate Ltd. v. Versatile Investments Ltd. an employee's breach of the
"common law duty of trust and confidence" allowed the court to consider
punitive damages. In Bee Chemical Co. v. Plastic Paint Ltd., each
ex-employee breached the duty "not to use special information which he
obtains while he is in that employ for his own purpose and contrary to the
interest of his employer". In a decision later affirmed by the Ontario
Court of Appeal, Parker J. awarded $25,000 in punitive damages to the
plaintiff employer.

Thus, it appears that a punitive damage award can be an effective
remedy for the protection of confidential information in the employment
relationship. This protection will be even stronger if the Supreme Court
of Canada approves of punitive damage awards for breaches of express terms
of contract.
FOOTNOTES: CHAPTER VI

1. (1854) 156 E.R. at 145.


5. The Mareva injunction can be traced to the judgment of Lore Denning in *Nippon Yusen Kaisha v. Karageorgis* [1975] 3 All E.R. 282 at pg. 283 which was applied in *Mareva Compania Noviera S.A. v. Int. Bulk Carriers J.A.; The Mareva* [1980] 1 All E.R. 213 (C.A.) This type of interlocutory injunction is granted to prohibit an owner of specific assets from dealing with the assets in certain ways. A typical instance would be to prohibit an alleged debtor from transferring assets out of the jurisdiction to avoid execution by the creditor. See McAllister, D.M. *Mareva Injunctions* (1983) The Carswell Company Ltd., Toronto, Canada.

7. A constructive trust, apart from resulting trusts, may be defined as one which is not expressed in any instrument, but is imposed upon a person by a court of Equity upon the ground of public policy...so as to prevent him from holding, for his own benefit, an advantage which he has gained by reason of some fiduciary relationship subsisting between him and others, and for whose benefit only it is his duty to act **Taylor v. Davis** (1917) 41 O.L.R. (A.D.).

8. An Anton Piller order is an interlocutory remedy that is sought on an ex parte basis by a plaintiff who alleges that a defendant may suppress or destroy evidence favourable to the plaintiff. The order normally enables the plaintiff's agents to make direct investigations and searches at the defendant's premises. **Anton Piller v. Manufacturing Processes** [1976] 1 Ch. 55. See **Sony v. Makers International** [1981] 9 E.I.P.R. D-189; **Nintendo v. Coinex Video** (1982) 69 C.P.R. (2d) 122; **Bardeau v. Crown Food** (1982) 36 O.R. (2d) 355, order dissolved - 38 O.R. (2d) 411. The order has particularly been used to get details of the identity of otherwise unknown employees who have passed confidential information to third parties. **Mechanical C.P.S. Ltd. v. Annette Collins** (1979) E.I.P.R. D-95.

9. Account of Profits is the remedy which is designed to restore to the plaintiff the profits made by a defendant as a result of the


11. The assumption here is that the third party did not intentionally procure or induce the breach of the employment contract. Such intentional acts by the third party would allow the employer to claim damages for the tort of inducing breach of contract. *Salmond on the


15. (1849) 1 Mac. & G., at 25.

16. (1851) 9 Hare, at 241.


19. Id.


22. Id.

24. Id., at 416.


28. Id., para 3:53 at p. 44.

29. Id., para 3:54 at p. 45.

30. Id., at p. 110-137.


33. Larry Still, "Court Caseloads Turn Day in Court to Years" Vancouver Sun, April 18, 1983 at 1.


35. Id. at 249.


38. Id., All E.R. at 509.

39. Id., A.C. at 399.

40. Id., A.C. at 341.
40a. Lord Diplock further clarified the balance of convenience element in 

41. *Id.*, at 343.


43. *Yule Inc. v. Atlantic Pizza Delight Franchise (1968) Ltd.* (1977) 80 D.L.R. (3d) at 725 (Ont. H.C.). The three judges of the Divisional Court noted that the appellants argued that there were three separate tests available for the granting of interim injunctions. The Court summarized and identified the other two tests as the multi-requisite test and the multi-factor test. While the Court applied the American Cyanamid test, there was no indication of disapproval of the other alternate tests.


45. *Id.* at 136.


47. (1981) 59 C.P.R. (2d) 113 at 117 (Ont. H.C.)


50. *Id.* at 278.

51. *Id.*


54. *Id.*, at 764.

55. (1878) 3 App. Cas. 709 (H.L.).
56. Supra, note 53, at 765.

57. Supra, note 55, at 719-20.


59. Id., at 679-80.


61. Supra, note 53.


68. Supra, note 37.


70. The Law Commission (1981) Breach of Confidence (United Kingdom) at 69, para. 4.83.

71. Supra, note 69, at 1226-7.


75. Telex Corp. v. I.B.M. 510 F (2d) 894 (10th Cir 1975) awarded $1,000,000 in punitive damages for the misappropriation of I.B.M.'s trade secrets. The trade secrets were disclosed by ex-I.B.M. employees.


76c. Supra, note 76a at p. 292.

76d. Id.

76f. On Jan. 11, 1985 the Globe and Mail reported on page B-2 a 6 million dollar punitive damage claim for breach of contract by Noranda Inc. against Seaboard Surety Co. The punitive damages claim is part of a wider claim for an alleged 50 million dollars in direct contractual damages. The uncertainty of the applicable law and the sheer amount of money involved makes this case worthy of a Supreme Court of Canada decision.

77. (1979) 50 C.P.R. (2d) 69 (Ont. H.C.).

78. Id., at 80.


81. Id., at 117 and 121.


83. (1978) 41 C.P.R. (2d) 175 at 180 (Ont. H.C.).

84. (1979) 47 C.P.R. (2d) 133 (Ont. C.A.), leave to appeal to the Supreme Court of Canada was dismissed on November 6, 1979.
VII CONCLUSION

It should be remembered that this thesis focussed on employment in the computer industry where legal rights to information are a major concern of the parties. The central objective of the research was to assess the adequacy of existing laws in meeting the needs of employers and employees, and to serve the interests of the public.

In general, the conclusion is that present Canadian law will be increasingly strained to protect adequately a computer industry employer against an employee's unauthorized appropriation of confidential information. In short, the law has not yet recognized the social and technological changes that have greatly increased the vulnerability of the information employer.

There have been certain specific conclusions that have emerged from the thesis research that support the general conclusion. Once these narrower conclusions have been presented, a number of general observations will be discussed.

In Chapter II the thesis explored an area of law where the courts have imaginatively kept pace with societal change. This chapter dealt with the legal principles that determine whether an individual qualifies as an employee. The various tests used by the courts to distinguish an employee from an independent contractor, agent or partner were reviewed. The existing case law does not compel the courts to apply a rigid framework for the determination of the employee status. Instead, the courts are given a wide ranging discretion in the choice of legal tests that can be applied. This broad discretion means that the courts are well
equipped to deal with the subtle problems of classifying the more independent, mobile and sophisticated information worker.

Other specific conclusions were made in the third chapter. This chapter surveyed an employer's proprietary rights to information from the perspective of social policy.¹ In order to protect an employer's proprietary rights to information, the law has always had to balance the interests of employers against the competing interests of employees and the public. In summary, the social and technological changes created by the information economy have created imbalances in this delicate weighting of the legal principles. The scales have shifted so that an employer in the computer industry is now operating at a marked disadvantage to its skilled employees.

If an appropriate balance is to be regained, the courts and legislatures must respond to the policy concerns created by:

1) an increasing commercial reliance on secrecy and confidentiality;

2) the number of legitimate groups who depend upon rights to information and who suffer from the confusion over the ownership of information;

3) unjustified policy biases in the existing law;

4) the policy objections to property rights in information.²

Chapter III also reviewed the specific legal protection available to employers in the computer industry.³ The general conclusion was that patent and copyright laws in Canada are only marginally effective in securing rights to information such as computer software. As a result, software distributors and employers have resorted to non-disclosure
systems such as the restrictive licensing of software. Trade secrets and the equitable obligations of confidence are currently the most effective and widely used legal protection for information rights in the employment relationship.

The implied and fiduciary obligations of skilled employees were discussed in Chapter IV. The overall conclusion was these obligations only offer minimal legal protection for an employer's confidential information. Even though a skilled employee has certain implied obligations of good faith, honesty and loyalty to his employer, there is a danger that such obligations may not be enforceable against computer industry employees who are covered by a collective agreement.

This possible lack of control over unionized employees comes from precedents of the Supreme Court of Canada.\textsuperscript{3a} These cases arguably rule that there can be no rights or duties arising out of the employment relationship except as spelled out in the collective agreement. Due to this problem and the general weakness of implied obligations, an employer must contract for express covenants in order to be minimally protected.

In spite of certain judicial reservations, it is clear that fiduciary obligations are applicable to highly skilled employees who receive confidential information. As the degree of secrecy, the associated expense and business importance of information increases, so does the possibility that the employee will be considered a fiduciary.\textsuperscript{3b} However, fiduciary obligations will only control an employee's conduct in limited circumstances. Moreover, the unsophisticated and immature status of the B.C. software industry also creates conflicts with fiduciary obligations. The cooperative strategies that are required for industry success are incompatible with the fiduciary requirements of secrecy and loyalty.\textsuperscript{3c}
Chapter V dealt with the doctrine of restraint of trade. An information employer must be particularly skilled in the use of express covenants of restraint. Instead of relying upon the minimal protection offered by implied obligations and fiduciary duties, employers should be aware of the following advantages to specific contractual restraints:

1) Wider interests can be protected via the use of express covenants;

2) Express covenants assist in proving the confidentiality of the employer's information;

3) Express covenants act as a warning and a deterrent for employees;

4) Injunctions can be issued more easily to prevent breaches of express covenants, than for breaches of implied or fiduciary obligations;

5) Express covenants do not displace implied or fiduciary obligations;

6) Express covenants establish an employer's claim to inventions and to copyrights.

In view of the relatively weaker protection provided by patent, copyright, and implied and fiduciary obligations, employers in the computer industry must act decisively at the time of hiring. An employer clearly achieves a stronger legal position by taking express covenants of non-disclosure and non-competition from the employee at the time of engagement.

The special status given to employment restraints under the common law was reviewed. Historically an employer has been required to face a higher burden of proof in the enforcement of employment restraints than would a purchaser of a business in an action against a competing former vendor. After reviewing the historical arguments, the conclusion was made that the special status accorded employment restraints was unjustified and inappropriate for skilled employees in the computer industry.
A number of more neutral conclusions were also made with respect to the elements of the restraint of trade doctrine. First, the doctrine normally only can be applied to restraints that limit an employee's liberty after the employment engagement. However, several authoritative English decisions have recently used the doctrine to set aside restraints that were being applied during the employment period. This limited exception occurs when the restraints are so extensive and unfair as to invite the court to interfere.  

A second observation relates to the public policy element in the doctrine of restraint of trade. Recent appeal court decisions in Canada and the United Kingdom have warned that prima facie assumptions are harmful to the public policy basis for the doctrine. In theory, once a court has determined that a restraint of trade exists, the proper second question is to ask whether the restraint of trade is so offensive as to be void by reason of public policy. However, the courts normally bypass the public policy element when faced with an employment restraint. The judgments start with the assumption that employment restraints are prima facie void. This pattern is likely to continue in spite of the warnings of the appeal courts, but there is little evidence that this assumption actually operates as a severe disadvantage for the employer.

The core of the restraint of trade doctrine has always been the reasonableness of the limitation being placed upon the employee. To determine the validity of the restraint, the courts look first at the nature of employer's interest being protected, and then at the spatial limitations being imposed. In order to qualify for protection, an employer must prove the existence of a proprietary interest: commercial or business advantages are insufficient. The three recognized types of
proprietary interests are business connections or customer goodwill, confidential information relating to the business, and any trade secrets revealed to the employee.8

One cautionary conclusion relates to the nature of the information shared by the employer and employee. The content of the information does not determine whether an employer has a proprietary interest. For example attempting to divide an employee's knowledge into know-how or trade secrets is not a fruitful way to identify a proprietary interest. Instead, the courts ultimately identify the interest by paying careful attention to the party's relationship, their conduct and to the industry within which the business operates.9

Chapter V discussed one detailed illustration of the inadequacy of proprietary rights to protect an information employer.10 The example selected was a software licensee who attempts to impose a restrictive covenant of non-disclosure upon its employees. Such covenants are required by software licensors in order to protect the confidentiality of the software trade secret. However such a licensor is only extending a right of use to the licensee. No transfer of proprietary rights to the software takes place between the parties. Since the licensee/employer does not possess a proprietary interest in the software, the doctrine of restraint of trade would therefore disqualify the employer from using the protection of a restrictive covenant. Equitable obligations of confidence can be imposed upon the employee, but the licensee is arguably unable to protect itself in contract. It is suggested that the courts should extend the definition of proprietary rights to include commercial or business advantages as a sensible way to enforce this type of restrictive covenant.
Technological and social changes have also resulted in a lack of protection for the public interest element in the doctrine of restraint of trade. The threat to the public interest arises from an overly limited definition of what constitutes the public interest. In theory, a post-employment restraint can be attacked by the covenantee on the grounds that the public interest will be harmed by its enforcement. However, the case law is quite unsettled on the definition of the public interest. A major conflict exists in the case law on the appropriate evidence that can be admitted to define the public interest.11

It appears that the Supreme Court of Canada must be called upon to resolve the dispute. A critical argument has arisen in the trial and appellate courts over the economic and social evidence which a court can properly consider in defining the public interest.

If a more liberal approach towards the allowable evidence is adopted by the Supreme Court, the doctrine of restraint of trade will ultimately require a court to assess an employment restraint in light of the effect on economic and social conditions affecting the public. Such an approach would allow the judiciary the scope to recognize the unique features of the computer industry. This thesis concludes that the doctrine of restraint of trade will not be able to fulfill its true role as an instrument of social policy without an expanded scope for the public interest element.

An employer in the computer industry is not disadvantaged by the existing principles on the onus of proof with respect to employment restraints.12 Each party has a separate onus of proof in ascertaining the reasonableness of covenants. The onus to establish that it is reasonable in the interests of the parties is on the employer who is
seeking to enforce the contract. The onus for establishing that the restraint is not in the interests of the public is on the employee who opposes enforcement.

More specifically, the employer/covenantee cannot rely upon what has sometimes been described as "the possibility of misuse doctrine." Instead the employer/covenantee has an affirmative burden to demonstrate a context in which the court can conclude that the employer's proprietary interest will be harmed by the employee's actions after termination. However, these principles on onus of proof do not impose an unreasonable burden on the employer.

Remedies for breach of an employee's obligations were analyzed in three specific areas. The first conclusion was that there is a generally adequate basis for a damage award against a third party who participates in or benefits from an employee's breach of confidence. Although there are uncertainties in the existing remedy, Canadian courts do have the power to award equitable damages. The Supreme Court of Canada has specified flexible guidelines for the calculation of the damages in equity.

The second remedial topic was the assessment of the granting of interlocutory injunctions against skilled employees who misappropriate confidential information. This remedy ranks as the most critical legal weapon to protect confidential information against employees or outsiders. Although the House of Lords in the American Cyanamid case attempted to lower the burden placed upon an applicant, the Ontario trial courts have so far refused to lower the employer's burden in an interlocutory injunction action. The refusal is motivated by the traditional policy statements regarding employment restraints such as the
"imbalance of power" in favour of the employer. Although the British Columbia trial courts appear to adopting a less restrictive approach, the failure to adopt the American Cyanamid guidelines presents a serious weakness for the protection of information in employment relationship in the computer industry.

The third remedial topic was to determine whether a court could grant punitive or exemplary damages against an employee for a breach of employment obligations. Canadian courts are currently using punitive damage awards as a very effective remedy for the protection of employment information.\(^{18}\)

**Concluding Observations:**

As with any area of law reform, there are two principal methods to improve the legal protection available to an information employer. The judiciary can take an active role in expanding the existing boundaries of the law, or the legislatures can undertake statutory reform.

There are indications that both of these routes might be followed in Canada in the next five years. First, a provincial law reform body has made the initial call for a statutory tort of misappropriation of a trade secret.\(^{19}\) The Institute of Law Research and Reform in Alberta recently distributed a discussion report which set out this recommendation. The Institute's tentative suggestion of a new statutory tort was prompted, in part, by the desire to protect existing and prospective information employers,\(^{20}\) and to extend the remedial powers of the courts.\(^{21}\).

There have also been two other related statutory proposals elsewhere in Canada. The B.C. Law Reform Commission has called for legislation to
permit partial enforcement of restrictive covenants under the doctrine of restraint of trade. Such a reform would deal with the harsh impact which an unenforceable restrictive covenant has upon an employer/covenantee.21a

The final statutory initiative comes from the Federal government. A white paper has been released which recommends amendments to the Copyright Act to clearly extend copyright protection to computer software. 21b

Second, in the past two years there has been a limited, but significant shift, in the position of the trial and appellate courts in Ontario. Even though the decisions do not directly deal with information in the employment relationship, the decisions show a clear judicial willingness to respond to technological change. In a trio of criminal law decisions, Regina v. Kirkwood22, Regina v. Stewart23, and Regina v. Turner24, the Ontario courts imaginatively used the criminal law to convict accused parties who had either arranged for the misappropriation of confidential information, sold counterfeit videotapes, or interfered with computer tapes without authorization.

Even more significantly, the first interlocutory decisions on copyright and the protection of software object code have now emerged. In an unreported 17 page interlocutory decision in I.B.M. v. Spirales25, the Federal Court ruled that both source code and object code were protected by copyright. The judgment establishes the copyright protection of software much more firmly than the previous cases noted in the thesis.26

These developments in the case law and the proposal for statutory reform hold out the hope of improved protection for employers in the computer industry. However, law reform proceeds at a snail's pace in comparison with the speed of technological change. Thus, in conclusion, it is doubtful if the law can keep abreast of the accelerating waves of change.
FOOTNOTES: CHAPTER VII

1. Supra, Chapter III at 35-47.

2. Id.


3a. Chapter IV at 92-93.

3b. Chapter IV at 97-98.

3c. Chapter IV at 99-103.

4. Supra, Chapter V at 110-117.

5. Supra, Chapter V at 118-123.

6. Supra, Chapter V at 127.

7. Supra, Chapter V at 129-130.

8. Supra, Chapter V at 130.

9. Supra, Chapter V at 137-140.

10. Supra, Chapter V at 141-144.

11. Supra, Chapter V at 149-150.

12. Supra, Chapter V at 156.

13. Supra, Chapter V at 159.

14. Supra, Chapter VI at 172-173.

15. Supra, Chapter VI at 177.

16. Id.

17. Supra, Chapter VI at 178-180.

18. Supra, Chapter VI at 188-192.


20. Id. at 59.

21. Id. at 88-91.


22. (1983) 5 C.C.C. (3d) 393, 42 O.R. (2d) 65 (Ont C.A.)


26. Supra, Chapter III at 51-60.


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