

SLEEPING WITH THE ENEMY:
RBC DOMINION SECURITIES V. MERRILL LYNCH
CANADA INC.

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INTRODUCTION

In just about every workplace, there is at least one employee who spends a considerable amount of time dreaming up ways to “get” their employer. Schemes, plots and plans to “stick it” to the employer have been fantasized about by employees for decades. Movies and television shows have often played on these fantasies. This is the story of one such scheme brought to life.

RBC DOMINION SECURITIES V. MERRILL LYNCH CANADA INC.

In *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.*, 2008 SCC 54 (CanLII), the Supreme Court of Canada found that employees may not be held liable simply for competing with their former employer during the reasonable notice period. In the decision, the Supreme Court overturned a damages award against a group of investment advisors who left RBC Dominion Securities Inc. (“RBC”) *en masse* in 2000, and immediately started working for Merrill Lynch Canada Inc. (“Merrill Lynch”) in direct competition with their former employer. In doing so the Court made some interesting observations regarding the obligations of departing employees.

Background

In Cranbrook, British Columbia, RBC and Merrill Lynch were each other’s main competitors in the investment advice market. RBC’s branch manager was a man by the name of Don Delamont. Mr. Delamont was good friends with James Michaud, who had become Merrill Lynch’s regional manager after working with RBC and its predecessors for almost twenty years. It appears that Mr. Delamont and Mr. Michaud had an axe to grind with RBC as they, with help from Merrill Lynch, managed to orchestrate a truly shocking mass *exodus* of employees.

In November 2000, Mr. Delamont, along with virtually all of the investment advisors employed by RBC Securities Inc. at its Cranbrook office, left their employment with RBC and immediately started working for Merrill Lynch. The only people who did not transfer were two members of the support staff and a pair of junior investment advisors, who were not asked to be part of the move. Mr. Michaud worked closely with Mr. Delamont in planning the move, including actively recruiting all of the employees who made the transfer. No advance notice of the decision to defect was provided to RBC by the investment advisors.

As if the mass departure was not bad enough, the evidence also disclosed that prior to the move to Merrill Lynch, RBC's confidential client records had been surreptitiously copied and transferred to its competitor.

Not surprisingly, RBC's Cranbrook office all but collapsed as a result of the defections. In response, RBC sued Merrill Lynch, Mr. Michaud, Mr. Delamont and the former investment advisors, claiming damages for breach of fiduciary duty, breach of an implied duty not to compete unfairly upon leaving RBC, failure to provide reasonable notice, misuse of confidential information (against Mr. Delamont and the other former employees), inducing breach of contract (against Merrill Lynch, Mr. Michaud and Mr. Delamont), and conspiracy and conversion (against all of the defendants). Notably, none of the employees who made the switch to Merrill Lynch had any restrictive covenants in their employment contracts.

The Trial Decision

At trial, Holmes J. of the British Columbia Supreme Court allowed the action, but dismissed the claims for conspiracy and breach of fiduciary duty against the employees. He held that no such duties were owed to RBC. However, the Court found that the employees had failed to provide reasonable notice of resignation and had competed unfairly with RBC by engaging in concerted efforts to transfer clients and by removing confidential client information before RBC could protect its business relationships. All of the remaining claims against Merrill Lynch, Mr. Michaud and Mr. Delamont were allowed.

At a second stage of the trial, Holmes J. assessed damages for the wrongs committed by the various defendants. The largest part of the damages award (almost \$1.5 million) was against the orchestrator, Mr. Delamont, for the loss of profits associated with the breach of his duty of good faith. However, the investment advisors were also found liable, in the amount of \$40,000 each, for a failure to give reasonable notice of resignation, as well as a total of \$225,000 for RBC's lost profits due to their unfair competition. Merrill Lynch and Mr. Michaud were also held jointly and severally liable for those damages (and an additional \$250,000 in punitive damages).

The Defendants Appeal to the Court of Appeal

On appeal to the B.C. Court of Appeal, the court was divided on the assessment of damages. The majority of the Court overturned the substantial damages award against Mr. Delamont, as well as the damages

ordered against the former employees for profits lost due to the unfair competition, but upheld the other damages awarded. Rowles J.A., in a partial dissent, would have upheld the damages against Mr. Delamont for breach of the duty of good faith.

The Supreme Court of Canada's Decision

RBC appealed the British Columbia Court of Appeal's decision regarding the damages assessed against Mr. Delamont and the departing investment advisors to the Supreme Court of Canada. With respect to the claim against Mr. Delamont, the Supreme Court agreed with the reasons of the trial judge and Rowles J.A. of the Court of Appeal. The Supreme Court found that the damages awarded were consistent with the claims pled against Mr. Delamont, and that the majority of the Court of Appeal applied the test for "proximity" of damages incorrectly. Further, the Supreme Court concluded that it would have been in the contemplation of RBC and Mr. Delamont, at the time of entering into the employment contract, that Mr. Delamont would be liable for the lost profits if he were to orchestrate the departure of almost all of the branch's investment advisors. Moreover, the use of a five year window for calculating the lost profits was found to be reasonable and supported by the evidence at trial.

With respect to the investment advisors' liability for "unfair competition", the Supreme Court ruled that the damages awarded could not stand. At trial, the Court had found that during the reasonable notice period, implied by law, employees continue to be under a general duty not to compete with their former employer. Since the investment advisors had violated this duty, they were liable for a percentage of the branch's lost profits. The Court of Appeal had unanimously rejected this approach, instead finding that once the employees left their employment with RBC, they no longer owed the employer any obligations (with the possible exception of not misusing confidential information acquired during the employment).

At paragraphs 18 through 20, the Supreme Court stated:

The majority of the Court of Appeal ... held that once the investment advisors left RBC, they were no longer under a duty not to compete with it. The view of the Court of Appeal on the law for the purposes of this issue may be summed up as follows. Generally, an employee who has terminated employment is not prevented from competing with his or her employer during the notice period, and the employer is confined to damages for failure to give reasonable notice (Southin J.A. for the majority). To this general proposition Rowles J.A. may be read as adding the qualification that a departing employee might be liable for specific wrongs such as improper use of confidential information during the notice period. This appears to be consistent with the current law, which restricts post-employment duties to the duty not to misuse confidential information, as well as duties arising out of a fiduciary duty or restrictive covenant: [citations omitted]. Neither of the latter duties are at issue here.

For the purposes of this case, the law may be accepted as summarized by the preceding paragraph. The contract of employment ends when either the employer or the employee terminates the employment relationship, although residual duties may remain. An employee terminating his or her employment may be liable for failure to give reasonable notice and for breach of specific residual duties. Subject to these duties, the employee is free to compete against the former employer.

To the extent the trial judge awarded damages on the basis that the employees continued to be under a general duty not to compete, this award of damages was wrong in law.

Accordingly, the appeal was allowed in part. The trial judge's decision was reinstated in respect of Mr. Delamont, while the Court of Appeal's decision denying damages for unfair competition was upheld.

CONCLUSION

While it may seem inherently improper for employees leaving one employer to be permitted to immediately commence working with a direct competitor, the Supreme Court of Canada's decision is clear that former employees are not prohibited from doing so, even where they have not provided reasonable notice of resignation.

Employers who may be vulnerable to mass defections should ensure that they include post-termination obligations in the employment contracts of those employees whose departures could harm the bottom line, as well as provisions dealing with the enforcement of such duties. This can be accomplished by way of restrictive covenants. In the absence of provisions that survive the end of the employment relationship, employers may be left with little, if any, resort when departing employees take the business with them.

While it is recommended that employers include appropriate restrictive covenants in all employment contracts, it should be noted that restrictive covenants, especially non-competition clauses, can be very difficult to enforce, as they are often viewed by the courts as an inappropriate restraint on trade. Accordingly, restrictive covenants must be drafted very carefully to maximize the potential that they will be upheld by the courts.

The Supreme Court of Canada's decision is not all bad for employers. The Supreme Court did reinforce that employees are required to provide reasonable notice of resignation, similar to an employer's requirement to provide reasonable notice when terminating one or more of its employees. The employees in the instant case were held liable for their failure to provide reasonable notice of resignation, thereby leaving RBC in a position where it all but collapsed. While the fact that the Supreme Court upheld the requirement for reasonable notice of resignation is helpful for employers, the best practice remains to include specific notice of resignation periods in each employee's employment contract.

The Supreme Court of Canada's decision also confirms that employees, whether in a fiduciary role or not, may not misuse their

employer's confidential information. Further, the decision confirms that managers owe a duty of good faith to their employer. Fortunately for employers and unfortunately for Mr. Delamont, the Supreme Court concluded that this duty of good faith includes not organizing or promoting a mass defection of virtually the entire workforce. On the bright side, while Mr. Delamont may be liable for more than a million dollars in damages for his actions, he may be able to make up for those losses should Hollywood come calling for the rights to this story.