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Avoiding Individual Liability - Good Governance for Technology Companies

In the wake of recently publicized failures of U.S. corporate governance, there has been a resurgence of demands for subjecting officers and directors of companies to individual liability for willful or negligent legal wrongs of the company for which they are responsible. In Canada, the scope of personal liability of corporate officers and directors has been redefined in recent years in cases involving patent, trademark or other intellectual property infringement.

As previously discussed in our December 2001 newsletter, the Federal Court of Appeal in *Mentmore Manufacturing v. National Merchandise Manufacturing* laid down the applicable criteria necessary to find a director or officer individually liable. The key element is whether the individual has merely acted as an officer or director in the ordinary course of business of the company, or whether the individual has acted willfully and deliberately or with indifference to the consequences of the legal wrong being committed.

What kinds of acts should give rise to personal liability? In *SOCAN v. 1007442 Ont. Ltd.*, the Court followed the *Mentmore* test to hold that directors can be held individually liable if found to have acted in “an intentionally dishonest” way to “deliberately cause the company to act illegally.” However, the Court does not go as far as to hold that the individual must know or have reason to know that the acts constitute infringement as a matter of law. As usual, ignorance of the law is no excuse for misconduct.

One way for corporate directors and officers to minimize their liability is to follow the principles of good corporate governance. The objective is to promote accountability of senior company personnel to the shareholders or investors; minimizing individual liability is a side benefit. Guidelines to be observed include the following:

IN THIS ISSUE:

Good corporate governance shields officers and directors from individual liability

The recipient of valuable information may be liable for its revelation or misuse, even without a contract of confidentiality

New European Union Design right

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Tension exists between the need to impose liability on individuals for torts that they commit and the need of corporations to carry on their ordinary business without subjecting officers and directors to personal liability.

Companies can increase immunity to legal claims by establishing clear corporate governance guidelines and by taking the measures outlined in the article to improve the ability of the company to deal with governance issues.

First, companies should ensure that the Board possesses a full complement of the expertise the company will require. Corporate directors must exercise diligence and apply acquired knowledge relative to the decisions they make. If each director circumscribes the exercise of discretion to his or her area of expertise, then the director will be responsible only for indiscretion exercised in that area.

Second, all members of the Audit Committee should have a good understanding of accounting practice and principles, and at least one should be a chartered accountant.

Third, consider forming a Corporate Governance Committee, whose job it would be to monitor and evaluate the performance of members of the Board against established benchmarks and criteria.

Fourth, every sizable technology company could benefit from the creation of a Scientific Advisory Board, comprised of outside experts to guide the company in its research and development. The purpose of this panel of experts would be to expand the expertise upon which the company is able to draw when making major decisions.

Note that the foregoing and other constructive corporate governance measures are not merely defensive; they can greatly improve corporate performance.

Confidentiality in Business Dealings

Jack has a good idea. Jill has the money and savvy to bring the idea to commercial reality. Without a confidentiality agreement, Jack discloses his idea to Jill and asks for her help. Jill likes the idea but now that she knows it, sees no reason to involve Jack in its exploitation, and commercializes the idea herself. Does Jack have a remedy?

Asking the question in a more general way, in the course of joint ventures or similar arrangements that are likely to involve one party's disclosing confidential information to another, is the recipient of the information obligated to the revealer that the disclosed information will be used only for their mutual benefit, or else will be kept confidential if the relationship dissolves? In the simple case where there is a clear oral or written contract of confidentiality, the revealer may sue the recipient for breach of contract if the disclosed information is misused or improperly communicated by the recipient. But is it established law that, even in the absence of a binding confidentiality agreement, the court may hold the recipient of information liable for a breach of confidentiality? If so, under what theory? Breach of confidence and breach of fiduciary duty come to mind.

On the issue of the breach of fiduciary duty, a fairly old decision of the Supreme Court of Canada in *Lac Minerals Ltd. v. International Corona Resources Ltd.*

sheds light on cases in which a quasi-fiduciary obligation might be imposed on the recipient of information, in the absence of a contract. In this case, Corona, a junior mining company, had disclosed confidential geological findings to representatives of Lac Minerals, a financing company, during negotiations for the proposed purchase of a potentially valuable property (the "Williams property"). However, at no point during the negotiation was the matter of confidentiality explicitly raised. The negotiations between Lac Minerals and Corona failed, whereupon Lac Minerals used the confidential information to acquire the property adjacent to the Williams property. The Supreme Court held for Corona in the lawsuit that followed, pointing out that a fiduciary obligation arises in a relationship where one party is entitled to expect that the other will act compatibly with the purposes of the relationship. La Forest J. held that it was industry practice to expect that "a legal obligation would be imposed on Lac not to act in a manner contrary to Corona's interest with respect to the Williams property" because there was a significant relationship of trust and confidence between the two parties. The Court held that the lack of a confidentiality agreement is not a sufficient reason to deny the existence of a fiduciary obligation. It would have been unreasonable to clutter normal business practice by requiring a contract.

While entering into a confidentiality agreement is optimum to protect confidential information, if the situation is one which the parties would reasonably expect to be treated confidentially, the law will impose an obligation of confidence.

In a recent decision, the Ontario Superior Court of Justice highlights the extent of the obligation to maintain confidentiality of information received from the revealer in the course of a meeting for a proposed joint venture. In *Enterprise Excellence Corp. v. Royal Bank of Canada*, the plaintiff, producer of a marketing program, was successful in its claim that the defendant had misappropriated the name of the program, "Today's Entrepreneur", which the plaintiff had disclosed to the defendant. At the time of the disclosure, the defendant had already developed a plan for a similar marketing program, but had not given it a name.

These cases manifest the principle that an actionable breach of confidence occurs when confidential information is improperly disclosed or is misused by the party to whom it was communicated, where there was a reasonable expectation of confidentiality by the revealer. In the *Enterprise Excellence* case, the loss of the name was a clear detriment to the plaintiff. It would have been unreasonable for the plaintiff to reveal this apt name to the defendant without the expectation of confidence. In awarding the plaintiff compensatory damages for the full evaluated amount of the marketing program, the Court concluded that as a result of the defendant's daily use of the name for many months, there was little or no value left in the name.

The foregoing principle is one of a group of fiduciary or quasi-fiduciary principles recognized by the law. The law requires that each party to an ostensibly cooperative business relationship act toward the other with good faith.

In short, where there is an implicit understanding of confidentiality or a relationship of trust, then even in the absence of a contract, the court will compensate the revealing party for the unilateral exploitation of confidential information or improper communication of same by a recipient party to the detriment of the revealing party. Yes, Jack has a claim to assert against Jill, and may expect to be successful if he can prove that the circumstances of his disclosure to Jill were such as to give rise to a reasonable expectation of confidentiality.

European Design Protection

Patents are granted for the novel and unobvious utilitarian aspects of an article of manufacture. An article of manufacture may also embody novel aesthetic or ornamental characteristics of its shape or configuration. If so, it may be protected by an industrial design registration in Canada or by a design patent in the U.S. Until now, if design protection of the latter sort were sought in Europe, separate applications to register the design in each country had to be filed, at considerable expense. Now, as of January 2003, a Registered European Community Design (RCD) is available that will cover present and future members of the European Community. The exclusive right granted by such RCD is for an initial term of 5 years with possible renewals up to a maximum of 25 years. The RCD concept of “design” is liberal, including, for example, shapes and configurations of articles of manufacture and handicrafts, ornamentation, type fonts, textures, material selections, computer icons. Qualifying designs will be protected as applied to any product whatsoever.

Our best guess is that the preparation and filing of an RCD application will cost less than $2,000, including official fees, and that prosecution of the application will be simple and rapid, with a Certificate of Registration granted within 6 months of filing. There will be an initial delay, as the new system will not be fully operational until 1 April 2003.

The RCD design must not have been previously published (i) by the owner, more than a year prior to the filing of the application for registration; (ii) by anyone else prior to the filing of the application or else prior to an earlier filed application from which Convention priority is available. Convention priority will normally be available if an earlier Canadian filing for a counterpart industrial design registration preceded the RCD filing by no more than 6 months. Drawings or photographs illustrating the design must be filed with the application.

One advantage of the new RCD system is that it will be possible to file a multiple application for more than one design of the same general category with reduced official fees for the other designs illustrated and described in the application.

Copyright Assignment

Winkler v. Roy, a recent Federal Court decision, serves as a reminder that it is not possible to make a complete assignment of copyright for the full term, *viz* the author’s lifetime plus 50 years after the author’s death. Under Canadian copyright law, ownership of copyright for the final 25 years of the term reverts to the author’s heirs. An assignment purporting to cover the full term will be upheld only for the lifetime of the author plus the first 25 years after death.

It used to be that to protect a novel design in Europe, a separate design application had to be filed in each country. Now you can file a single design application to cover the entire European Union. Almost any novel design qualifies for protection.

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