

BEYOND THE FOUR WALLS OF THE EMPLOYMENT CONTRACT - GOOD FAITH, FIDELITY AND FIDUCIARY DUTIES

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In the area of employment law, a large number of cases brought by employers against their former employees dealt with the express restrictive covenants of the employment contract such as the non-compete, non-dealing and non-solicitation clauses. However, the existence of implied terms in employment contracts should not be overlooked. This update examines the law on the breach of implied terms in employment contracts in light of a recent decision by the Singapore High Court.

Smile Inc Dental Surgeons Pte Ltd v Lui Andrew Stewart

In the case of Smile Inc Dental Surgeons Pte Ltd v Lui Andrew Stewart SGHC 241 ("**Smile Inc**"), the plaintiff ("**Smile**") had employed the defendant ("**Dr Lui**") as an associate dentist. Some years into his employment, Dr Lui incorporated his own company, Dental Essence Pte Ltd ("**Dental Essence**"). A month after incorporating Dental Essence, he resigned from Smile to commence his own business in a location which is within 5 minutes' walk from Smile's clinic. Thereafter, Smile experienced a decrease in monthly revenue in respect of the branch that Dr Lui worked at prior to his resignation. Many of Smile's patients subsequently requested for their dental records and left to become patients of Dental Essence. As such, Smile brought an action alleging that

Dr Lui had breached the following:

- various express provisions of his employment contract which restricted him from undertaking certain activities ("**restrictive covenants**"); and
- the duty of good faith and fidelity and fiduciary duties, which are implied terms of the contract ("**the implied terms**").

Non-enforceability of the Restrictive Covenants

The Court first examined the express provisions of the employment contract which Smile alleged that Dr Lui was in breach of. The restrictive covenants in question were the geographical limitation clause, the non-solicitation clause and the non-dealing clause. The court found that it was unreasonable to preclude Dr Lui from soliciting patients he had not treated before or deal with Smile's patients when he did not solicit for them. Furthermore, it was significant that all three clauses were unlimited in the duration of the restriction. Accordingly, the restrictive covenants were void and unenforceable on the basis that they were unreasonable in reference to the interests of the parties.

As the Court found the restrictive covenants to be unenforceable, the Court went on to deal with the implied duties of good faith, fidelity and fiduciary duties owed by Dr Lui to Smile.

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Breach of the Implied Duties

Smile claimed that the following acts or omissions by Dr Lui were breaches of the implied terms of his employment contract while he was still employed with Smile:

- setting up Dental Essence
- signing a tenancy agreement for the premises of Dental Essence;
- fitting out the premises of Dental Essence;
- discussing/negotiating with Dr Pearson resulting in Dr Pearson becoming a shareholder and director of Dental Essence, with a view to Dr Pearson working as a dentist at Dental Essence;
- applying a licence from the MOH to practice dentistry with Dental Essence;
- failing to inform Smile of all or any of the foregoing matters; and
- failing to obtain Smile's consent to the setting up of Dental Essence.

Dr Lui argued that these steps were merely preparatory steps and he was entitled to compete with Smile after terminating his employment with Smile. As such steps were merely preparatory acts, Dr Lui argued that they did not constitute breaches of fiduciary duty. Smile on the other hand, took the position that even if the steps could be considered preparatory, Dr Lui had breached the implied terms.

Court's Decision in Smile Inc

The Court considered several authorities on this point and concluded that Dr Lui was not in breach of the implied duties. The Court distinguished between preparatory steps and actual competitive activity. While an employee owed a duty of good faith and fidelity to his employer, the Court was of the view that it would not be a breach of such a duty where the employee merely took steps to prepare to compete with his former employer.

On the issue of whether there was a breach of fiduciary duty, the Court refused to impose any fiduciary duty on Dr Lui. It was of the view that there was nothing special about Dr Lui's employment which gave rise to fiduciary duties. As such, reasonable restrictive covenants would have sufficed to mitigate the effect of Dr Lui's influence and rapport with patients. As there was no finding of the existence of any fiduciary duty, it was unnecessary to consider the issue of breach.

The Intention and Plan to Compete

The Courts maintained that an employee had the right to plan his future before his departure, even if this means competing with the employer. The intention to compete is not sufficient to constitute a breach of an employee's fiduciary duty and merely making a decision to set up a competing business at some point in the future and discussing such an idea with friends and family would not itself be in conflict with the best interests of the company and the employer. As such, the non-disclosure of the intention to compete does not constitute a breach of an employee's fiduciary duty.

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Preparatory Steps

Mere preparatory acts to compete are insufficient to constitute a breach of the implied duties of good faith and fidelity. An employee may prepare a place for his business, employ others in such preparation, obtain a lease of premises and order materials in preparation to compete against the plaintiff company.

In Smile Inc, taking up a lease of premises, committing to renovating the premises, acquiring equipment before resigning from Smile and approaching a former dentist from Smile to join the clinic that he was setting up was not found to go beyond the usual preparatory steps in setting up a company.

Active Steps to Compete

However, when an employee takes steps to actively compete with the employer, such acts would amount to a breach of fiduciary duty. Acts that amount to active competition include the acts of soliciting the employer's customers and diverting business opportunities. The misuse of confidential information which constitutes trade secrets are also breaches of the employees' fiduciary obligations and their implied obligation of fidelity.

Position and Job Scope of the Employee

An employee's position and the role in which he plays in relation to soliciting customers for the employer may be an important factor in deciding whether fiduciary duties arise in the first place. In Smile Inc, since Dr Lui was employed merely as an associate dentist and was not obliged to actively find new patients for Smile, the Court did not find anything special about Dr Lui's employment by Smile which would give rise to fiduciary duties and therefore, there could not be any breaches of fiduciary duties.

However, where an employee holds a senior position or his position¹ has a bearing on the employer's relationship with clients, the Court may find breaches of fiduciary duty and a duty to serve the employer faithfully. This may be found where, for example, the employee's responsibilities include sales generation and marketing.

Conclusion

Implied terms form an integral part of all contracts today, including employment contracts and the Courts will imply terms into contracts to give business efficacy to contracts made between parties.

In the context of employment contracts, an employee breaches the implied terms of good faith and fidelity when the employee takes active steps to compete before the cessation of employment, but not for preparatory steps taken. In certain cases, an employee also owes fiduciary duties to the employer, depending on the employee's seniority and the employee's position in the company. In the event that the employee owes fiduciary duties to the employer, setting up a competing business may constitute a breach

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of fiduciary duties.

While breaches of restrictive covenants commonly form the cause of action for employers pursuing a case against their former employees, the breaches of implied terms of the contract can find a cause of action as well. The implied duties cast a wider protective net in safeguarding the employer's interests beyond the four corners of the employment contract. This cause of action would be particularly applicable where there is no restraint of trade clauses in the employment contract or where the restraint of trade clause would be unenforceable due to unreasonableness.

In Smile Inc, the plaintiff founded its claim on both the restraint of trade clause and the implied duties under the contract. After the Court in Smile Inc found the restraint of trade clause to be unreasonable, the Court went on to consider the claim on the breach of implied duties under the contract. Even though the Court ultimately arrived at a negative finding on the claim under the implied duties, the case highlights the viability of such claims. Smile is currently appealing the case to the Court of Appeal and it is hoped that the Court of Appeal would shed more light into claims in the area of implied duties under employment contracts.

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