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Business founder required to disgorge profits from competing powder-coating business

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One of the essential obligations of someone who enters into a business venture with other shareholders of a small corporation is to refrain from engaging in a competing business or taking opportunities that properly belong to their company.

In *7868073 Canada Ltd. v. 1841978 Ontario Inc. and Sugar v. Vacuum Metallizing Limited, 2022 ONSC 4557* [not on CanLII], the Ontario Superior Court of Justice addressed fiduciary duties owing under licensing agreements for the commercialization of intellectual property and the entitlement to profits from powder-coating work sourced by the fiduciary.

In 2010, an individual (Langlois) approached two potential investors about co-venturing in a "powder-coating" business, which involves applying powder-coating to products rather than liquid paint. Langlois presented an ambitious plan to make millions of dollars in a short time in the business, about which the other two investors knew next to nothing. The three individuals formed two companies for the business named Architectural Coatings Solutions (ACS) and Transreflect and held the shares in a numbered company. Both companies are referred to collectively as ACS.

In turn, Langlois entered into a licence agreement in which he granted a broad licence to the ACS numbered company respecting certain intellectual property he claimed to own, as well as his equipment, processes, trade secrets, manufacturing and distributing techniques, and knowledge acquired over many years in the powder-coating industry.

Despite substantial investment by the plaintiffs, the venture was a failure. In the court's words, Langlois "overpromised and underdelivered."

However, while the ACS venture was ongoing, Langlois started assisting another individual (Jeffrey), in developing powder-coating methods for Jeffrey's company, Vacuum Metallizing Limited (VML), to try and win a lucrative contract. VML was a liquid painting company that was open to expanding into the powder-coating realm.

Eventually, Langlois left ACS and

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entered into a new venture in the powder-coating industry with Jeffrey and his brother Gary Sugar, a corporate lawyer. The new venture was incorporated under the name Power Coating Solutions Inc. (PCS). Langlois and Jeffrey replicated the ACS business plan for PCS.

The PCS venture also failed, but not before earning revenue from the sale of three powder-coating machines and a lucrative powder-coating contract with RM2 Canada Inc.

However, PCS was not the only company to benefit from the RM2 Contract. Within a matter of months of PCS commencing work on the RM2 Contract—and without notice to Gary— Jeffrey and Langlois arranged to transfer the RM2 Contract to VML, effectively cutting Gary out of the profits.

When the co-founders of ACS discovered what Langlois had done, they sued Langlois, alleging, among other things, that Langlois had breached the licence agreement and his fiduciary duties, including his duty of confidence by starting a competing business. Jeffrey and Gary were named as defendants on the basis that they had knowingly assisted Langlois in the breach of his duties to the ACS founders. In response, the defendants essentially argued that PCS was a completely different venture than ACS. Gary, in turn, sued Langlois and Jeffrey for diverting the RM2 contract from PCS to VML.

A trial was eventually conducted during 2021-2022, and the plaintiffs in the ACS action were overwhelmingly successful: *7868073 Canada Ltd. v. 1841978 Ontario Inc. and Sugar v. Vacuum Metallizing Limited*, 2022 ONSC 4557 [not on CanLII].

The court determined that the licence agreement granted by Langlois was for an unlimited period, being "a grant in perpetuity," or until terminated in accordance with its terms. The court cited with approval a passage from J. McCamus, *The Law of Contracts*, 3rd ed. (Toronto: Irwin Law, 2020), at p. 844, stating that "there is no reason, in principle, precluding the parties from agreeing to indefinite or perpetual obligations and if, on the proper construction of the agreement, a perpetual obligation is intended, it will be enforced."

The court assessed whether the licence agreement was invalid as unconscionable or an improper restraint of trade and rejected the defendants' position since the imposition of a restraint of trade arises once the relationship between two contracting parties comes to an end, and one party is restrained from doing certain things in competition with the other. Since Langlois began to compete with his ACS partners while the licence agreement was still in effect, this prevented him, at law, from sharing his intellectual property, know-how and experience with anyone other than the founders of ACS.

As to Langlois' fiduciary obligations to ACS and its founders, the court referred to the general principle that where a company is closely held between a small number of shareholders who act as partners in a joint venture, those shareholders owe fiduciary duties: *Jordan Inc. v. Jordan Engineering Inc.*, 2004 CanLII 5863 (ON SC), at para 35; *Tourangeau v. Taillefer*, [2000] O.J. No. 184 (S.C.J.) (QL) [not on CanLII].

The court had little difficulty concluding that Langlois owed fiduciary duties to ACS and his former partners. The issue was whether Langlois not only breached the licence agreement but whether he breached his fiduciary duties in pursuing a competing venture with Jeffrey and Gary. The court considered the "ripeness" of the corporate opportunities and the circumstances in which they were obtained and the factor of time in continuation of the fiduciary duty.

There were two corporate opportunities at issue: the contract with RM2 for powder-coating and

the sale of three powder-coating machines, based on Langlois's designs. Although these opportunities may not have been available while Langlois was at ACS, the court stated that they were not a "fresh initiative". In *GasTOPS Ltd. v. Forsyth*, 2012 ONCA 134, the Ontario Court of Appeal affirmed that the opportunity in question does not need to be an opportunity that the company would have obtained, in order for the fiduciary to be in breach of his fiduciary duty if he seizes that opportunity.

In the case at hand, instead of directing the RM2 opportunities to ACS, to which Langlois continued to owe a duty of loyalty, good faith and contractual obligations, he delivered the RM2 Contract to the new ventures with Jeffrey and Gary. This misappropriation of corporate opportunities was a breach of Langlois's fiduciary duties to ACS and his former business partners.

Furthermore, Langlois's conduct fell well short of the general standard 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. He left ACS without notice to his partners to form a new company which would compete with ACS. He had already appropriated the ACS business plan for the new company before he told his partners that he would be leaving ACS to join Jeffrey and Gary. He took with him all of his alleged intellectual property, as well as the rights that he had licensed to ACS, including his know-how, experience, and expertise in powder-coating, his related designs and products, and ACS equipment.

The court further concluded that Jeffrey and Gary knowingly assisted Langlois in the breach of his fiduciary duties to his former ACS partners in the formation of a new business in which they hoped to benefit despite any detriment to the plaintiffs. Jeffrey, the court reasoned, must have known that Langlois was deceiving his ACS partners when they simply changed the name in the written business plan. Gary, a lawyer, did not take reasonable steps to confirm that Langlois was not subject to an ongoing fiduciary duty to ACS and instead went into a competing business with him. Damages for knowing assistance do not depend on the knowing assistant's receipt of property. The court found both defendants jointly and severally liable for profits earned by PCS and VML, together with PCS and VML whose liability was vicarious.

In the result, the court found that the sale of three powder-coating machines by PCS and the RM2 contact were corporate opportunities that ought to have been available to ACS but for Langlois's breaches of the licence agreement and of the fiduciary duties he owed to ACS and his former partners. Gary and Jeffrey were found to have knowingly assisted Langlois in the breach of his fiduciary duties.

Langlois and PCS were therefore liable for approximately $2.5 million as prophylactic disgorgement of the profits they had realized in breach of their obligations. Jeffrey and VML were found to be liable for half that amount. The second action brought by Gary was dismissed as moot.

The case is a cautionary tale about pursuing competing opportunities that properly belong to an ongoing venture whose owners are entitled to an accounting for any profits they should have been able to realize. The courts generally take a dim view of the undisclosed pursuit of competing business opportunities by a fiduciary and anyone who assists them in doing so.

Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact James Cook, at 416.865.6628 or jcook@grllp.com.

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