

Clocking Out And Cashing In: When An Employee Side Hustle Becomes Your Competition



The Ontario Court of Appeal (“**ONCA**”) has issued a timely reminder that when it comes to employee-created intellectual property, there is no substitute for a well-drafted employment agreement.

In the recent decision of *Nexus Solutions Inc. v. Krougly* (“**Nexus Solutions**”),^[1] the ONCA held that copyright in competing software developed secretly by an employee during his employment belonged to the *employee* and not the employer. The result, which the trial judge himself described as “harsh,” turned on the absence of a written employment agreement and the narrow scope of the employee’s assigned duties.

The Importance of Employee-Created IP

Employees routinely create works in the course of their employment, from software code and business plans to technical reports, training materials and graphic designs. To secure ownership, many employers include intellectual property (“**IP**”) assignment provisions in their employment agreements. Without such provisions, employers must rely on section 13(3) of the *Copyright Act* (the “**Act**”), which provides that the employer is the first owner of copyright in works created by an author “in the course of his employment,”^[2] but only in the absence of any agreement to the contrary.

As *Nexus Solutions* makes clear, the protection offered by section 13(3) of the Act is narrower than many employers may assume.

Background

Vladimir Krougly (“**Krougly**”) was employed by Nexus Solutions Inc. (“**Nexus**”) as a senior software developer. Krougly did not have a written employment agreement with Nexus. During his employment, Krougly secretly developed a competing software product called “Limedas,” which directly competed with Nexus’ own software offering, “CEMView.” After resigning from Nexus, Krougly attempted to commercially market the Limedas software – including to some of Nexus’ own customers. When Nexus discovered what Krougly was doing, it commenced an action against Krougly, claiming copyright ownership of the Limedas software under section 13(3) of the Act.

The central question before the court was whether the Limedas software was created

“in the course of [Krougly’s] employment” by Nexus.

Analysis

Both the trial judge and the ONCA answered “no” to the central question.

The trial judge applied the following factors, drawing on the non-exhaustive list identified in the British decision of *Penhallurick v. MD5 Ltd.*, to conclude the Limedas software was not created “in the course of employment”:[\[3\]](#)

1. **the terms of the contract of employment:** there was no written employment contract between Krougly and Nexus restricting Krougly from working on his own projects on his own time or allocating ownership of anything he might create
2. **where the work was created:** the bulk of the work done on the Limedas software was done outside of Nexus’ premises
3. **whether the work was created during normal office hours:** the bulk of the work done on the Limedas software was done by Krougly outside of normal business hours
4. **who provided the materials for the work to be created:** Nexus did not expend any resources to develop Limedas and Krougly used his personal time and equipment to do so
5. **the level of direction provided to the author:** Nexus had never asked or directed Krougly to develop Limedas
6. **whether the author can refuse to create the work:** this was not a relevant factor for Krougly as he was never asked or directed to develop Limedas
7. **whether the work is integral to the employer’s business:** although the trial judge found that Limedas was related to Nexus’ business, it found that Limedas could not be an *integral* part of the business as the ideation and development of the software was clearly a side venture.

On appeal, Nexus argued that it *could* have directed Krougly to develop software like the Limedas software, and that it should therefore own the copyright in the Limedas software. The Court of Appeal rejected this interpretation. In the court’s view, the test turned on what the employee was actually asked to do, instead of the broader universe of tasks the employer theoretically could have assigned to the employee.

The overriding question under section 13(3) of the Act is whether the making of the work was something the employee was asked or expected to do, either expressly or by necessary implication, as part of their employment responsibilities. Because Krougly’s responsibilities were explicitly limited to the development of the CEMView software, and he was prohibited from working on other software, the ONCA determined that Krougly’s development of the Limedas software fell outside the scope of the Act.

A Key Distinction from *Corso*: the Employee’s Mandate

The courts distinguished the facts in *Nexus Solutions* from those in *Corso v. Nebs Business Products Limited*,[\[4\]](#) where that court found that the employer did own the copyright in software surreptitiously created by an employee. In that case, the ideation and development of new software products was an integral part of the employee’s responsibilities.

Put simply, an employer with a broadly defined mandate for its technical employees (one that encompasses creating new and innovative products) is in a far stronger position under section 13(3) of the Act than one that assigns its developers to a single existing product or otherwise restricts the mandate of its technical employees.

What About the Employee's Misconduct?

The trial judge concluded "with considerable reluctance" that Nexus was not entitled to a proprietary remedy under copyright law, acknowledging that this was a "harsh result" given that Krougly had surreptitiously developed software intended to compete with Nexus' existing software. However, the purpose of copyright law is not "to punish bad actors simply because their actions may run afoul of their duties towards their employers." [5]

Importantly, the underlying action was bifurcated so claims outside of copyright law such as breach of fiduciary duty and conversion were not addressed and may remain live.

A Note on Derivative Works

Notably, while the CEMView and Limedas software performed similar functions, the trial judge accepted that they were substantially different – different source code, different algorithms. In other words, Limedas was not a wholesale copy of CEMView. That finding matters beyond this case. Had the employee's product been more closely modeled on the employer's existing software, the employer may have been able to assert rights over it on the basis that it owned the underlying work on which the new product was based.

Takeaways for Employers

Nexus Solutions is a reminder that, absent appropriate contractual and organizational safeguards, employers cannot assume that they will own IP created by employees. Employers should protect their interests by taking the following steps:

- **Use Written IP Assignment Agreements:** Canadian employers are well-advised to include IP assignment provisions with appropriate scope in all written employment agreements and not rely on an expansive (and potentially erroneous) interpretation of section 13(3) of the Act. A well-drafted IP assignment clause can capture works created by an employee that fall outside their strictly assigned duties, closing the gap that proved fatal to Nexus.
- **Obtain Moral Rights Waivers:** Although not the subject of *Nexus Solutions*, written and signed moral rights waivers are integral to ensure that an employer can freely use employee-created works. Moral rights are ancillary to copyright, held by an author of the work with respect to the integrity of the work and the right of the author to be associated with the work by name or pseudonym. [6] For more information about moral rights, please refer to one of our recent bulletins available [here](#).
- **Define Employee Roles in Writing:** Employers should ensure that employee roles, particularly for those involved in developing innovative products and services, are clearly defined in a job description. As *Nexus Solutions* demonstrates, a narrow, undefined or undocumented scope of duties risks employer IP exposure.
- **Use Non-Solicitation, Non-Competition and Confidentiality Agreements:** A key failure of Nexus was that it did not have a non-solicitation agreement with Krougly to prevent him from soliciting its customers after his resignation. Similarly, employers may implement contractual non-competition or exclusivity obligations during employment, and in some cases, after employment ends. Both non-solicitation and non-competition agreements must be carefully drafted to maximize chances of enforceability and comply with local law. Further, confidentiality agreements can explicitly and indefinitely prevent employees from misusing information they gained during their employment.
- **Get Integrated Employment and IP Advice:** Employers benefit from obtaining both employment and IP advice when developing hiring practices, employment agreements

and workplace policies. It is crucial to have robust IP contractual provisions and to address IP risks at the outset of the employment relationship.

Conclusion

Nexus Solutions draws strict boundaries around section 13(3) of the Act: it protects employers only to the extent they have actually directed the work at issue, not merely because they could have. The case illustrates that the Act's default rules may leave employers without a remedy. Nevertheless, this risk is avoidable. Through carefully drafted agreements and clearly defined roles, employers can protect their most valuable assets.

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