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Employment and Labour Law Update

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Ontario Court of Appeal Clarifies Wallace Damages

The Ontario Court of Appeal has released an important decision restricting the circumstances under which a terminated employee may claim damages for an employer's bad faith conduct. In *Mulvihill v. Ottawa (City)* the Court unanimously ruled that a terminated employee will not *necessarily* be entitled to *Wallace* damages where: (i) the employer initially takes the position that there was just cause to terminate, and then abandons its position prior to trial; and/or (ii) dismisses the employee while on sick leave.

This ruling, while pre-dating the Supreme Court of Canada's recent decision in *Honda v. Keays*, is consistent with the principles expressed in *Honda*. Both decisions confirm a fundamental proposition: when evaluating an employer's conduct to determine whether a dismissal was carried out in "bad faith" the court must consider whether, in all of the circumstances, there may have been a legitimate reason for the employer's conduct. It is not necessary that the court agree with the employer's choice of action. In fact, the court may find that the termination was unlawful. The issue is whether the employer acted honestly and in good faith. In other words, not every wrongful dismissal will result in a successful claim that the termination was carried out in bad faith.

Wallace Damages

In the 1997 case of *Wallace v. United Grain Growers Ltd. ("Wallace")* the Supreme Court of Canada held that an employee may be entitled to damages when the employer engages in *unfair or bad faith conduct* during the employee's dismissal. Since the *Wallace* decision, virtually every statement of claim alleging wrongful dismissal has contained a claim for *Wallace* damages. The plaintiff in *Mulvihill v. Ottawa (City)* was no exception.

The Facts

Ms Mulvihill was a City employee who went on sick leave because of "stress" after alleging a co-worker had harassed her in the workplace. Even though she failed to properly file her harassment claim, the City still investigated Ms Mulvihill's complaints. A third party investigator ultimately found that the complaints were without merit.

Unsatisfied, Ms Mulvihill refused to return to work unless she was reassigned to a different department. She called into question the ability of her supervisors to perform their jobs and complained about her supervisors in an e-mail message addressed to the Chief Corporate Services Officer of the City, the City Manager and the Mayor. She also questioned the integrity of the investigator.

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An employer is not required to act *perfectly* during the course of a termination. What *is* required is that the employer act honestly and in good faith.

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Notably, at no time did Ms Mulvihill request to have the decision of the investigator reviewed.

As a result of her actions, Ms Mulvihill was terminated for insubordination and for failing to return to work after being requested to do so. The City initially took the position that it had just cause to terminate Ms Mulvihill's employment, but withdrew this position after pre-trial discovery examinations. The City also agreed to pay the three-month severance amount specified in Ms Mulvihill's employment contract.

The Trial Decision

The trial court awarded Ms Mulvihill ten months' salary and benefits. This included entitlements under her employment contract, *plus* an additional five-and-one-half months' salary in respect of *Wallace* damages. The judge found that *Wallace* damages were warranted for two reasons: (i) the allegation of cause was not warranted; and (ii) the dismissal took place while Ms Mulvihill was on sick leave.

The Court of Appeal

The Court of Appeal overturned the trial judge's ruling regarding *Wallace* damages on three principal bases.

First, the Court disagreed that Ms Mulvihill was entitled to *Wallace* damages simply because the City withdrew its cause allegation prior to trial:

> The mere fact that cause is alleged, but not ultimately proven, does not automatically mean that *Wallace* damages are to be awarded.
>
> …
>
> There are numerous reasons why an employer might resile from the position that dismissal was for cause, including a willingness to compromise and to resolve disputes without the necessity of a trial.

According to the Court of Appeal, the key factor in assessing whether *Wallace* damages should be awarded is whether or not the employer acted in *bad faith*. In this case, there was a basis for the City to have reasonably concluded that a dismissal for cause was justified.

Second, the Court found that the City was "candid, reasonable, honest and forthright" when it explained to Ms Mulvihill the reasons why she was being terminated, namely her insubordination and refusal to return to work. The City had therefore met its obligation to treat Ms Mulvihill fairly and in good faith during the course of her termination.

Third, the Court of Appeal disagreed that the City had exhibited bad faith by terminating Ms Mulvihill while she was absent from work while on stress leave. Acknowledging that the decision to terminate while she was on stress leave was "a mistake" on the part of the City, the Court reaffirmed what the Ontario Superior Court of Justice held in *Yanez v. Canac Kitchens* in December, 2004 by stating that:

> …the legal standard against which conduct is to be measured for the purposes of Wallace damages is not whether an employer made a mistake but, rather, whether the employer engaged in unfair or bad faith conduct. A mistake is not conduct that can be said to be unfair or bad faith.

Finally, and significantly, the Court held that the termination of an employee who is on sick leave is not, in and of itself, bad faith conduct. There must be "other evidence of bad faith, unfair dealing or 'playing hardball'."

Lessons Learned

The Court of Appeal's decision in *Mulvihill v. Ottawa (City)* confirms a number of important considerations for employers:

1. The *manner* in which an employee is terminated continues to be the critical factor in assessing whether the employer will be liable for *Wallace* damages.
2. *Wallace* damages will not be awarded merely because an employer abandons or withdraws an allegation of cause before trial, or dismisses an employee while on sick leave.
3. An employer is not required to act *perfectly* during the course of a termination. Indeed, an employer can make a mistake. What *is* required is that the employer act honestly and in good faith.

Finally, an important reminder: while a termination can, in the right circumstances, be carried out while an employee is absent due to health reasons, employers must be extremely careful when considering this course of action. Courts and the Ontario Human Rights Commission (should a human rights complaint be filed) will carefully scrutinize an employer's actions and underlying motivation if an employee is terminated under these conditions.

To learn more about this decision and how it may impact your workplace, please contact a member of the Sherrard Kuzz LLP team.

DID YOU KNOW?

The Ontario Court of Appeal recently upheld a $2 million damage award against an employer (*Brewers Retail*) in favour of a dismissed employee. The employee had been fired for theft, and then charged and convicted criminally. Ultimately he was exonerated on the basis that the employer had mislead police and prosecutors and had engaged in "malicious prosecution". To learn more, give us a call.

La-Z-Boy Caught Reclining While Drafting Employment Contract, Says Court of Appeal

In response to increasing judicial and legislative expansion of employee rights, many employers have learned the importance of protecting themselves by means of written contracts.

In *Braiden v. La-Z-Boy*, decided this June by the Ontario Court of Appeal, employers were reminded that it is not enough merely to *attempt* such written protection; employers need to *ensure* that their written documentation fully conforms to well-established case law requirements.

The Facts

Gordon Braiden began his employment in 1981, and continued his employment as a customer service manager until 1986. That year he was assigned a combined salaried and commissioned sales role, which soon further transformed into straight commissioned sales.

In 1995, La-Z-Boy initiated a practice of requiring each salesperson to sign an annual written fixed-term employment agreement ("Agreement") which contained a provision entitling La-Z-Boy to terminate employment at any time upon provision of 60 days' notice. At trial Mr. Braiden explained that he felt he had to sign the Agreement in order to keep his job. In fact, he signed Agreements each year so that by the time of his termination of employment in 2003, he had signed nine successive agreements, each with an identical 60 day termination clause.

La-Z-Boy took further steps in 1998 to contractually protect its interests by requiring Mr. Braiden to incorporate. From that point forward, the Agreements were with between La-Z-Boy and Mr. Braiden's corporation, not with Mr. Braiden in his personal capacity.

The Agreements also defined Mr. Braiden's and later his corporation's status as an "Independent Marketing Consultant" and stated that the relationship was not one of employment, but rather of an independent contractor.

In 2003, La-Z-Boy terminated the Agreement with Mr. Braiden's corporation and provided 60 days' notice. In response to Mr. Braiden's subsequent wrongful dismissal lawsuit, La-Z-Boy pleaded that: (i) its relationship was with Mr. Braiden's corporation and a corporation has no right to reasonable notice; (ii) even if the relationship was with Mr. Braiden, he was an independent contractor who also had no right to reasonable notice; and (iii) the contractual 60 days' notice provision governed.

The Court of Appeal's Decision

The Court of Appeal sided with Mr. Braiden in respect of each of the three arguments.

First, the Court held that the corporate status of the subordinate contracting party (Mr. Braiden's corporation) did not prevent a wrongful dismissal action. The essential purpose of the relationship was for Mr. Braiden to provide his personal services.

Second, the Court held that Mr. Braiden was an employee and not an independent contractor based upon the following factors: (i) he was limited to servicing La-Z-Boy exclusively; (ii) prices, territory and promotional methods were determined solely by La-Z-Boy; (iii) he had not undertaken any business risk and had no expectation of profit (beyond a fixed commission); and (iv) he was part of a sales force which was a crucial part of La-Z-Boy's business organization, as opposed to providing services that were merely ancillary to La-Z-Boy's overall operations.

As for the contractual stipulation of 60 days' notice, the Court of Appeal observed that Mr. Braiden had the benefit of an implied right to reasonable notice of termination when the first Agreement was signed. The law presumes this right in most employment relationships. The law also permits this right to be restricted by the use of an employment contract. However, in order to do so, an employer must adhere to very rigid and technical rules set down by legislation and case law.

For example, where an employment contract is used in the course of an employment relationship, an employer must be able to demonstrate that the employee received something of value (known as 'consideration') in exchange for signing the contract. Very often, when a contract is signed before employment begins, that 'consideration' is the job itself. If the contract is signed after an employee has already started work, even if they've been there only a day, or if a change is made to an important term of the contract, new consideration or value must be provided for the contract to be enforceable.

> *Consideration, if it is to be given, must be made clear in the contract.*

In the case of Mr. Braiden, the Court of Appeal relied on one of its statements from an earlier decision, that removal of the right to reasonable notice is "a tremendously significant modification" of an individual's rights and approvingly quoted another prior statement:

> … the terms of the employment contract rarely result from an exercise of free bargaining power in the way that the paradigm commercial exchange between two traders does. Individual employees on the whole lack both the bargaining power and the information necessary to achieve more favourable contract provisions than those offered by the employer, particularly with regard to tenure.

According to the Court, La-Z-Boy's introduction of the 60 days' notice provision through the new contract stripped Mr. Braiden of his right to reasonable notice, without providing any consideration or benefit to him. The Court rejected La-Z-Boy's argument that tax benefits, which Mr. Braiden was alleged to have gained by incorporating, were sufficient consideration. La-Z-Boy had led no evidence that tax benefits were realized. Further, any such benefits were not provided by La-Z-Boy but were an incidental consequence of the transaction. The Court noted that consideration, if it is to be given, must be made clear in the contract. Theoretical benefits cannot be argued after the fact in an effort to ferret out "hidden" consideration.

Because there was no consideration, the 60 days' notice provision in the Agreement was held to be null and void, and Mr. Braiden was entitled to reasonable notice of termination. That Mr. Braiden re-executed the Agreement on multiple of occasions did not assist La-Z-Boy. Mr. Braiden was awarded a judgment of nearly $140,000 plus legal costs.

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"La-Z-Boy" continued from inside...

The Court of Appeal found it unnecessary to consider Mr. Braiden's alternative argument which had been accepted by the trial judge, that the 60 days' notice provision was null and void because it was less than the statutory minimum termination and severance pay stipulated in the Ontario *Employment Standards Act*.

Lessons Learned

In siding with the employee on each contentious issue, the Court of Appeal relied on at least three of its own well-established decisions which were sufficiently similar to Mr. Braiden's claim.

In the final analysis, La-Z-Boy failed in multiple ways to protect its own interests. Had La-Z-Boy been more alert to the detailed requirements set out in previous, well-known case precedents, it could have protected itself by using a properly drafted contract before the employment relationship even started. Alternatively, when seeking to implement a contract after the relationship had begun, it could have provided appropriate, fresh consideration to Mr. Braiden so that he would have become bound to the restricted notice provision.

There are various options available to employers to assist them to lawfully and effectively manage their business. A properly drafted employment agreement is but one important example.

To learn more about how to protect your organization through the use of properly drafted and implemented employment contracts, please contact a member of the Sherrard Kuzz LLP team.

HReview Seminar Series

Please join us at our next *HReview* Breakfast Seminar:

Overtime Pitfalls & Wrongful Dismissal Update

1. "Going Into Overtime" - Damages and Strategies

- Overview of *The Employment Standards Act* Hours of Work Provisions
- Recent Overtime Class Action Litigation
- How to Protect Against Overtime Claims

2. Wrongful Dismissal Update

- What's New in the Case Law?
- The Evolution of *Wallace Damages*

DATE: **Tuesday September 9, 2008, 7:30 – 9:30 a.m. (program at 8:00 am; breakfast provided)**

VENUE: Holiday Inn Hotel & Suites, 7095 Woodbine Avenue, Markham (Woodbine and Steeles) 905.474.0444

COST: Please be our guest

RSVP: By Friday August 29, 2008 to info@sherrardkuzz.com or 416.603.0700

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