

Fiduciary Duties May Not Survive Wrongful Dismissal

In a recent decision of the Ontario Superior Court of Justice the court ruled that the wrongful termination of a fiduciary employee will relieve that employee of any and all fiduciary duties post termination.

The decision in *Zesta Engineering Ltd. v. Cloutier* ("Zesta") exposes employers to considerable risk in the event that a fiduciary employee is terminated without cause and without reasonable notice.

FIDUCIARY EMPLOYEES AND POST-EMPLOYMENT FIDUCIARY DUTIES

The implications of Zesta are best understood if we begin by briefly reviewing the law of fiduciary employees and their post-employment fiduciary duties.

It is established law in Canada that certain "key" employees owe "fiduciary" duties to their employers. Generally understood, these upper echelon employees are considered "fiduciary" employees because they have the discretion to act unilaterally and through such action affect the employer's interests. They are therefore considered to hold positions of trust and confidence and as such are "fiduciaries".

Because of the significance of the "fiduciary" position, courts have imposed certain implied duties and obligation on fiduciary employees over and above the general implied duties owed by all employees. And because the duties are implied, they bind the fiduciary employee even in the absence of a written employment contract.

Post-employment fiduciary duties are particularly critical to the protection of an employer's business interests. For example:

- While employees generally have a duty to respect a former employer's trade secrets and customer

lists, a fiduciary employee is prohibited from directly soliciting the former employer's customers.

- The fiduciary is prohibited from soliciting employees of the former in an effort to have them join the fiduciary in a competing venture.
- A fiduciary must not use information gained through employment to take advantage of a business opportunity being pursued by his/her former employer.

Employers may be without recourse to prevent a former fiduciary from soliciting customers and employees or usurping a favourable business

Thus, while a fiduciary employee is not entirely prohibited from competing, she cannot compete through solicitation or by confiscating business opportunities from the former employer.

It is also well established that post-employment fiduciary duties are time limited - the fiduciary employee remains bound for such reasonable period of time as would enable the employer to solidify and secure its customer relationships.

However, as a result of the court's decision in Zesta, it now appears that

if an employer wrongfully dismisses a fiduciary employee, that employee may be relieved from any further fiduciary duties to the employer.

THE ZESTA DECISION

In Zesta, the court considered a claim by the employer, Zesta, against five former senior managerial employees. Zesta had terminated the employment of these employees alleging cause on the grounds that they were planning to set up a new company in direct competition with Zesta by using Zesta's confidential information and soliciting Zesta's customers.

Following the terminations, Zesta sought injunctions and damages against the five fiduciary employees on the basis that they had breached their fiduciary duties.

In their defence, the employees did not dispute that they were fiduciary employees of Zesta, but pleaded that they had been wrongfully dismissed.

The court considered two principal questions:

1. Had the employees been wrongfully dismissed?
2. If the employees had been wrongfully dismissed, did their fiduciary duties survive the wrongful dismissal?

In respect of the first question, the court concluded that Zesta had wrongfully dismissed the employees. The court found that although the employees had in fact set up a competing business and solicited Zesta customers, they had done so after their terminations. That is, the evidence did not support the conclusion that the employees were involved in setting up a competing business while they were employed. Accordingly, at the time of the dismissals, Zesta did not yet have cause.

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In respect of the second question, the court concluded that because the employees had been wrongfully dismissed they were, by virtue of the employer's breach of the employment agreement, relieved of any further fiduciary duties.

In so concluding, the court adopted a line of authority that stands for the proposition that if an employer terminates an employment contract unlawfully - without reasonable notice or contrary to its specific terms - the employer is deemed to have repudiated the contract. In turn, the employee is entitled to accept the repudiation and is relieved from all further obligations under the contract. The court relied upon the following analysis taken from an earlier commentary on the subject:

"...it should be remembered that fiduciary obligations are imposed by equity, not by law, and are subject to the more general rule that a person who seeks an equitable remedy must come to court with clean hands. It appears therefore unlikely, except in the rarest of circumstances, that an employer who dismisses a fiduciary without cause will have any remedy if that person subsequently solicits his customers."

IMPLICATIONS OF ZESTA

The decision in Zesta puts employers at considerable risk in the event that a fiduciary employee is terminated with-

out cause and without reasonable notice. In addition to damages for wrongful dismissal, employers may be without any recourse to prevent the former fiduciary from soliciting customers and employees or from usurp-

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ing a favourable business opportunity.

In addition, the decision in Zesta applies equally to restrictive covenants contained in written employment contracts designed to prevent competition or solicitation by employees. That is, where a court finds that an employee's employment has been terminated wrongfully, applying Zesta, the court is

unlikely to hold the employee bound by the terms of a restrictive covenant unless the covenant contains clear language indicating a contrary intention.

WHAT SHOULD EMPLOYERS DO?

In light of the decision in Zesta, employers should always consider the following:

- Before terminating a fiduciary employee, assess carefully the potential harm the employee could cause to the business if he/she solicits customers or employees, or seeks to usurp business opportunities.

- If there are significant risks, think twice before alleging cause. If you are wrong, a court is likely to relieve the employee from fiduciary obligations.

- Even if the employer is not alleging cause, assess the reasonable notice period carefully and present a reasonable severance package. A former employee may argue that the termination was wrongful because insufficient notice or pay in lieu was offered.

- If the employee has a written employment contract with termination provisions, follow the termination provisions precisely.

- For new employees, employers should consider the use of written employment contracts to secure reasonable restrictive covenants. Such covenants should clearly indicate the agreed intention of the parties that the employee would remain bound by the terms of the contract post termination, "regardless of how the termination should occur".

DID YOU KNOW...?

The Sarnia Construction Association has been designated as a "Designated Regional Employer Organization" in Ontario Labour Relations Board Area #2 for purposes of negotiating changes to ICI Provincial Agreements.

Requirement for Pre-Start Health and Safety Review

As of October 7, 2000, the Industrial Regulation under the Occupational Health and Safety Act requires a Pre-Start Health and Safety Review ("PHSR") whenever there is the construction, installation or addition of a new, or modification of an existing, apparatus, structure, protective element or process, in a 'factory'.

Many employers may not yet have had occasion to require a PHSR, so we have taken this opportunity to briefly outline the PHSR requirements. If you require further information regarding PHSR's we encourage you to consult with counsel.

WHEN IS A PHSR REQUIRED?

Employers that operate workplaces that are 'factories' are required to complete a PHSR prior to the construction, addition or installation of a new, or modification of an existing, apparatus, structure, protective element or process when one or more of the following circumstances applies:

1. flammable liquids are located or dispensed in a building room or area;
2. the use of a dust collector involves a risk of ignition or explosion that creates a condition of imminent hazard to a person's health or safety;
3. a factory produces aluminum or steel or is a foundry that melts materials or handles molten material;
4. a process uses or produces a substance that may result worker exposure in excess of exposure limits;
5. equipment utilizes a safeguarding device that signals the apparatus to stop, or a barrier guard that uses interlocking mechanical or electrical safeguarding devices;
6. material articles or things are placed or stored on racks or stacking structures;
7. a process involves a risk of ignition or explosion that creates a condition of imminent hazard to a person's health or safety; or

8. the construction, installation or modification relates to a lifting device, traveling crane, or automobile hoist.

A "factory" is defined by the Act as virtually any manufacturing, repair, warehousing, assembling, retail or similar operation. In some circumstances, this may include construction work performed at a factory.

Failure to conduct a PHSR in circumstances where one is required may result in charges under the Act, and in the event of an accident involving the equipment or process at some later date, the failure to perform a PHSR would significantly undermine a defence of due diligence.

WHEN IS AN EMPLOYER EXEMPTED FROM A PHSR?

A number of exemptions to PHSR's apply. However, given the complexities of the Regulation, it is recommended that any assessment of whether an exemption applies be approached with considerable care and caution.

An example of when an exemption would apply is as follows:

- the installation of equipment which uses a defined protective element (such as a guard, light curtain, safety mat systems, two hand control systems, etc.), and
- the employer can positively demonstrate (through the prescribed documentation) that the protective element was installed upon manufacture of the equipment, and
- the employer can positively demonstrate that the equipment was manufactured and installed in accordance with "current applicable standards".

While "current applicable standards" are not defined in the Regulation, the Ministry of Labour has issued guidelines indicating those standards, both generic and machine-specific. We note, however, that the

guidelines are not law, and do not bind the Ministry or an Occupational Health and Safety adjudicator.

Similarly, a PHSR is not required for the addition or modification of storage racks, if the employer has the documentation prescribed by the Regulation to prove that the structure was designed for and tested for use in accordance with current applicable standards. We note, however, that the Ministry's guidelines state that PHSRs do not apply to all racking systems, and the guidelines should be consulted on this point.

WHO PERFORMS A PHSR AND WHAT MUST IT CONTAIN?

The owner, lessee and employer at the workplace are jointly responsible for ensuring completion of a PHSR when one is required. In the vast majority of circumstances, a PHSR must be performed by a professional engineer.

The PHSR must:

- be in writing,
- be signed by the person who performed it,
- contain the details of the measures that must be taken to bring the apparatus, structure, protective element or process into compliance, and
- be kept accessible at the workplace, along with any supporting documentation, for as long as the equipment remains in the workplace.

Employers should consider requiring the individual preparing the Report to provide a preliminary copy prior to it being finalized, as this may permit the employer to correct some or all deficiencies prior to issuance of the final Report.

THE ROLE OF THE JOINT HEALTH AND SAFETY COMMITTEE

The employer must provide the Joint Health and Safety Committee with a copy of the Report before the appara-

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tus, structure, protective element is operated, or the process is used.

Where an exemption applies, upon request, the employer must provide the Committee with documents establishing the exemption.

If some or all of the measures required by the PHSR are not taken prior to use of the equipment or process, written notice to the Committee of the measures that will be taken to comply with the Regulation are required.

AT WHAT POINT SHOULD AN EMPLOYER TURN ITS ATTENTION TO A PHSR?

The Regulation does not require a PHSR in circumstances where an employer can prove that equipment was manufactured, installed and tested in accordance with accepted standards. Accordingly, employers are encouraged to pursue compliance with the Regulation's requirements from the design stage, or when sourcing suppliers for equipment. Doing so will not only help employers avoid costly retrofits in order to comply

with the Regulation, but will ensure compliance with the Regulation and a safer workplace from the outset.

Employers are reminded that completing a PHSR is not a full answer to an employer's obligations under the Act. Employers must still comply with all other provisions of the Act, including any obligations over an above a PHSR, as well as ensuring the employer has taken all reasonable steps to ensure that existing equipment, machinery, processes, etc. which may not be subject to a PHSR does not pose a threat to the health or

Breakfast Seminar

Sherrard Kuzz LLP would like to thank all those who joined us at our most recent HReview seminar (May 15, 2002: "Reducing Turnover, Retaining Talent.")

The discussion included:

- Current and future trends in turnover;
- Costs associated with turnover;
- Strategies for developing and retaining key leaders;
- Coaching your workforce; and
- Corporate Reputation: Becoming The Employer Of Choice.

If you were unable to attend and would like a copy of the seminar materials, please contact Angela Duldhardt at aduldhardt@sherrardkuzz.com. We welcome your feedback at info@sherrardkuzz.com.

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Seminar Series

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