MANAGEMENT COUNSEL

Employment and Labour Law Update

SHERRARD KUZZ LLP

Employment & Labour Lawyers

"...in the context of a wrongful dismissal, even monies payable by a third party, such as a disability benefits insurer, may be recoverable from the employer..."

April 2006 Vol. V No. 2

Premature Termination of Benefits Comes With a Price

A recent decision of the Ontario Court of Appeal stands as a reminder that an employer's liability flowing from a termination of employment may sometimes extend well beyond payment of severance. In *Egan v. Acatel Canada*, the Court held that an employee who became disabled after termination and prior to expiry of the notice period, but after benefits coverage had been cut off, can claim against the employer directly for loss of benefits.

THE FACTS

Mary Egan commenced employment with Alcatel Canada in 2000, after being induced to leave her previous employment of 20 years at Bell Canada. After employment of only 21 months with Alcatel, she was dismissed without just cause on July 3, 2002. Her employer offered the equivalent of 12 weeks' pay. Although no settlement was agreed upon, the employer maintained Ms Egan's membership in the group insurance policy, including short term disability ("STD") and long term disability ("LTD"), for a period of 12 weeks, expiring on September 25, 2002. The group STD and LTD policies stipulated that it was Alcatel, and not the insurer, who determined when coverage was terminated.

On October 1, 2002, 13 weeks after being terminated from her employment, Ms Egan became clinically depressed. She remained so for a period of one year. Unfortunately for Ms Egan, by the time of onset of her depression, Alcatel had already cancelled her membership in the group insurance policy. She made application for disability benefits, but because her enrolment in the disability benefits plan had expired, the insurer denied coverage.

In her wrongful dismissal action against Alcatel Canada, Ms Egan included a claim not only for pay-in-lieu of notice, but also for losses resulting from her inability to claim for STD and LTD benefits.

THE DECISION AT TRIAL

The judge at trial had sympathy for Ms Egan having been induced to leave her previously secure employment at Bell Canada. The judge took her prior service at Bell Canada into consideration and assessed her reasonable notice period at nine months.

However, the trial judge was not prepared to entertain Ms Egan's claim for loss of disability benefits. Instead, the trial judge held that the award of nine months' full salary, in-lieu-of notice, was sufficient to make Ms Egan "whole".

Having found a nine months' notice period, the time line for purposes of determining compensation, was as follows:

continued inside...

Premature Termination continued from p.1

Jul 3/02	Dismissal
Oct 1/02	Disability began (STD)
Jan 28/03	STD ended; LTD began
Apr 3/03	Nine months' notice period ended
Oct 1/03	Disability ended

THE DECISION ON APPEAL

The Court of Appeal disagreed with the trial judge, finding the decision to be in error in that it: (a) awarded Ms Egan full salary during the period October 1, 2002 to April 3, 2003, when she was disabled and would have been in receipt of income replacement (i.e. disability benefits that would have been paid at a lower rate than regular salary); (b) failed to compensate Ms Egan for the period April 3 to October 1, 2003 when her disability continued; and (c) failed to follow the compensation principle (i.e. placing Ms Egan in the same situation she would have been had she actually received nine months' notice of termination).

In order to understand why Ms Egan was able to claim lost disability benefits from the employer requires a return to first principles in the law of wrongful dismissal. The entitlement of an employee on termination of employment without just cause is not merely to a severance payment but rather to "reasonable notice" of termination. An employer may satisfy its obligation to provide reasonable notice by notifying an employee that, as of a fixed date in the future, the employee's employment will terminate. Provided that the future date of termination specified is "reasonable", the employer will have discharged its common law obligation to the employee. The giving of reasonable notice of termination - to be effective on a future, fixed date - is described as "working notice".

If an employer chooses not to give working notice the employer has the option to satisfy its obligation to the employee by providing pay-in-lieu of notice. In most cases, that compensation includes the salary and other forms of remuneration that the employee would have received from the employer had the employee been given working notice. In the case of Ms Egan, had she received nine months' working notice her disability benefits would have been in place at the time she became disabled and eligible to make a claim (October 1, 2002).

As such, the Court awarded Ms Egan compensation for lost benefits to November 1, 2003, even though her notice period had expired seven months earlier. The fact that she would have been entitled to disability benefits to November 1, 2003, if she had received reasonable notice of termination, is what enabled Ms Egan to achieve this result.

The Court did provide assistance to the employer in one respect. Commencing October 1, 2002 to the end of her notice period, April 3, 2003, Ms Egan was not compensated for both loss of employment income and loss of disability benefits. The Court held that this would have resulted in double recovery and overcompensation. Accordingly, Ms Egan was awarded loss of disability benefits only for that period of time.

As if the overall result was not painful enough for the employer, the Court of Appeal also made an adjustment to the damages awarded because of the income tax consequences of Ms Egan receiving compensation from the employer directly, rather than from the insurer. The payment of compensation for lost disability benefits was taxable as a "retiring allowance" under the *Income Tax Act*. The reason is that had Ms Egan received the disability benefits directly from the insurer the benefits would have been tax free. Accordingly, if Ms Egan were to receive merely the same amount of gross payments from the employer as she would have received from the insurer, she would have less money in her hands once income tax was deducted and remitted. The Court therefore applied an income tax "gross up". In other words, it made an upwards adjustment of the amount of compensation in order to compensate the employee for the extra income tax she would have to pay because the monies would be paid by the employer. This resulted in nearly doubling the $75,727 figure which would have been received tax free in the form of STD and LTD benefits, to a gross award of $141,307.[1]

The final award included payment to Ms Egan of the equivalent of her full remuneration from the date of termination to the onset of her disability plus the grossed up disability benefits from that date onward.

LESSONS LEARNED

The Court's finding confirms the proposition that, in the context of a wrongful dismissal, even monies payable by a third party, such as a disability benefits insurer, may be recoverable from the employer if the failure of the employer to provide reasonable notice of termination results in the employee not being able to claim disability benefits.

Given that the provisions of the insurance policy permitted Alcatel to determine the timing of discontinuing benefits, in hindsight, Alcatel might have considered extending benefits voluntarily for a longer period of time, taking into consideration the surrounding circumstances.

The risk of adopting such a strategy, of course, is that it is difficult to predict accurately what a court will determine constitutes "reasonable notice". In this case, the reason the court determined that reasonable notice was nine months was because of a finding that Ms Egan had been induced to leave Bell Canada. Absent a finding of inducement, her entitlement to notice would likely have been considerably less. Voluntarily extending benefits, without an appropriate release, also comes with the risk that a court might interpret the employer's gesture as implicit recognition of a longer period of notice. A more predictable method for an employer to avoid such an outcome is by stipulations in an employment contract.

Whatever the employer chooses to do to limit or avoid such liability, it is essential to review the terms of the group insurance policy with legal counsel and the employer's insurance broker.

[1] In this case, it deserves mention that the employer was not self-insured for disability benefits, but rather, had an insured plan that was designed to permit benefits to be paid out by a benefit carrier to the employee "tax free". Had this not been the case - - in other words, had the employer been the party responsible for paying out benefits directly, and the benefits were taxable in the employee's hands- - the Court may not have decided to "gross up" the settlement.

Bill C-55: Reining in the Courts in Restructurings

Federal legislation passed by the former Liberal Government on November 21, 2005 would provide greater protection for employee interests during the course of corporate restructuring or insolvency affecting the employer. However, given the recent change in government, whether Bill C-55 will come into force in its current form is an open question.

Bill C-55 establishes the *Wage Earner Protection Program Act* ("WEPA"), and amends the *Bankruptcy and Insolvency Act*, and the *Companies' Creditors' Arrangement Act* ("CCAA") among other statutes. It will come into force on a date to be fixed by the government in Council (not earlier than June 30, 2006).

> "...Bill C-55 is intended to end uncertainty by removing any notion that courts may unilaterally impose an amended collective agreement on the parties."

WHAT IS AT STAKE?

One of the principal purposes of the CCAA is to facilitate compromise between a company and its creditors as an alternative to bankruptcy. In the context of such a crisis, there is often great pressure to renegotiate the contents of collective agreements in order to provide to the employer greater financial flexibility. As recent high visibility restructurings have reminded us, the treatment of collective agreements in restructuring is often crucial - both as a practical matter and as a matter of public policy - as insolvency law and labour relations intersect at a critical time.

The CCAA is silent regarding collective agreements and collective bargaining in restructuring. Therefore, the courts have traditionally relied on their inherent jurisdiction to deal with the many complex issues that arise within the context of a CCAA proceeding. The result has been an inconsistent application and understanding of the sanctity - or lack thereof - of collective agreements.

The Federal Government maintains that Bill C-55 is intended to end uncertainty by removing any notion that courts may unilaterally impose an amended collective agreement on the parties. This is distinct from the regime in the United States where employers may unilaterally "disclaim" a collective agreement during reorganization under Chapter 11, subject to being able to demonstrate to a court that the balance of equities favour such action.

HOW THE BILL WORKS

There are two key components of the CCAA reform as it relates to labour relations: 1. Bill C-55 affirms the "sanctity of collective agreements", preventing court-appointed monitors or the court itself from amending them unilaterally, and 2. Bill C-55 sets out conditions under which a judge overseeing a reorganization may authorize the employer to seek to renegotiate a collective agreement to which it is bound.

Should it come into effect in its current form, where an employer is unable to reach a voluntary agreement with its union to modify the terms of an existing collective agreement, Bill C-55 would give an employer only one option: apply to the court for an order authorizing the employer to serve a notice to bargain under applicable labour laws. According to the Federal Government the opportunity to "bargain under applicable labour laws" will strike a balance between "the interests of the employer's restructuring and the employees...by placing any [collective agreement] negotiations into the context of labour law rules that both the employer and union understand and with which they are comfortable. This should improve the likelihood of success of any negotiations".

The court will not authorize service of the notice to bargain unless the employer can satisfy the following three-part test, the elements of which, flexible by necessity, will surely be tested in the courts:

(a) a viable compromise or arrangement could not be made, taking into account the terms of the collective agreement,

(b) the employer has made good faith efforts to negotiate changes to the collective agreement, and

(c) a failure to issue the order is likely to cause irreparable damage to the employer.

Where the court authorizes bargaining, there is no guarantee

continued on back cover

DID YOU KNOW?

The Ontario government is planning to introduce legislation that would change the complaints process for claims under the Ontario Human Rights Code. This would mean that complaints would no longer be run through the Commission, but instead individuals could file them directly with the Ontario Human Rights Tribunal - the body that conducts hearings.

Bill C-55 continued from p.3

that an agreement will be reached. Where it is not reached, it will be up to the creditors to accept or reject the reorganization plan that includes the existing collective agreement. Where the collective agreement is amended following bargaining, the union is deemed to have a claim, as an unsecured creditor, for an amount equal to the value of the concessions.

WAGE EARNER PROTECTION PROGRAM ACT ("WEPA")

Employees' interests are protected by Bill C-55 in another significant respect through the enactment of WEPA. Projected to assist up to 15,000 employees a year at a cost of up to $50 million, WEPA guarantees the protection of an employee's wages up to $3000 per employee during the period of six (6) months prior to the employer declaring bankruptcy or entering receivership.

"Wages", defined as including salary, commissions, compensation for services rendered, vacation pay and other amounts prescribed by regulation, but not severance or termination pay, is capped at the greater of $3000 and four times insurable earnings under the *Employment Insurance Act*. Employees employed three months or less, officers, directors, owners and managers are not eligible to receive payment under the program.

Perhaps the most important aspect of WEPA is that it will move up employees from near the bottom of the creditor list. Under the current regime, only about 20% of unpaid employees receive payment from the bankrupt employer, and those who do usually receive funds roughly three years after the fact. WEPA would give an employee wage priority over claims of secured creditors up to a maximum of $2000.

ONE FINAL NOTE

Although Bill C-55 was passed by the House of Commons this past Fall, some commentators have been critical of the legislation pointing to technical glitches that may have resulted from the Bill having been rushed through Parliament prior to this winter's Federal election. Perhaps in recognition of this haste, in approving the Bill, the Senate Banking Committee received "unqualified assurance" from the relevant Ministers that Bill C-55 would not come into force until June 30, 2006 at the earliest, providing the Committee an opportunity to undertake a more thorough review of the Bill. The net result is that there may be changes to Bill C-55 before it becomes law.

Sherrard Kuzz LLP will keep its readers and clients apprised of developments.

SHERRARD KUZZ LLP
Employment & Labour Lawyers

155 University Avenue, Suite 1500
Toronto, Ontario, Canada M5H 3B7
Tel 416.603.0700
Fax 416.603.6035
24 Hour 416.420.0738
www.sherrardkuzz.com

BREAKFAST SEMINAR

HReview Seminar Series

Next in our series of employment and labour law updates:

TOPIC: **BIOMETRICS - THE NEW FRONTIER**

Employers today face unprecedented challenges reconciling security, safety and privacy issues with the overarching objective of running a business. We will address:

- The permissibility of background checks
- The impact that bioscreening and palm and retinal scans will have on the workplace
- What courts, arbitrators and Privacy Commissioners are saying about privacy rights in the context of employment screening

DATE: Thursday May 18, 2006, 7:30 a.m. — 9:00 a.m. (program to start at 8:00 a.m.; breakfast provided)

VENUE: The Toronto Board of Trade Country Club, 20 Lloyd Street, Woodbridge, ON L4L 2B9 416.746.6811

RSVP by Friday, May 5th to 416.603.0700 (tel), 416.03.6035 (fax), or mrhoden@sherrardkuzz.com

Providing management with practical strategies that address workplace issues in proactive and innovative ways.