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Recent Canadian court decisions regarding:

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AUTHORS:

Douglas G. Gilbert

Heenan Blaikie
dgilbert@heenan.ca

John C. Kloosterman

Littler Mendelson, PC
jkloosterman@littler.com


Littler

Employment & Labor Law Solutions Worldwide

Littler Mendelson, P.C.
littler.com • 1.888.littler

Heenan Blaikie

heenanblaikie.com • 416.360.6336

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This is the first issue of what we intend to be a regular series of newsletters on Canadian workplace law updates of interest to American employers with operations in Canada. In this issue, we look at several recent decisions from the Supreme Court of Canada and one from the Ontario Court of Appeal. Each of these decisions illustrate the contractual basis of employment in Canada and show how basic tenets of the employment relationship, and the laws governing that relationship, sometimes differ greatly from those on the other side of the border.

American employers doing business in Canada assume different responsibilities in the employment relationship than they may be used to assuming in the United States. For example, most American employees are employed "at-will," meaning either the employer or the employee can end the employment relationship at any time for any (or no) reason. In contrast, the principle of "at-will employment" is unknown in Canada. With every hiring, an implied employment agreement comes into existence that has implications when the employment relationship is terminated, when terms of employment are altered, and when the employee competes with the employer.

Canadian courts have recently tackled a wide range of controversial employment law issues, including damages for bad faith conduct in the termination of employment, constructive dismissal, enforceability of restrictive covenants, and duties owed to employees after the termination of employment.

Damages for Bad Faith Termination

In the United States, an at-will employee generally has no claim for wrongful dismissal unless the employee can show the existence of an implied employment agreement or the employee can show that his or her dismissal violated public policy. Accordingly, when employees are laid off or otherwise dismissed in the United States, there is, for the most part, no requirement that employees receive any specific amount of notice or any severance pay. In contrast, Canadian employees are entitled to receive a certain amount of notice of termination or pay in lieu of notice under minimum employment standards legislation and the common law. Accordingly, in Canada, employees who believe they have not received an appropriate amount of notice may bring a claim for wrongful dismissal.

In calculating damages for wrongful dismissal, Canadian courts have often awarded extra months of compensation to employees who have experienced unfair or humiliating treatment at the time of termination.

This trend has been reversed by a recent decision of the Supreme Court of Canada.

In *Keays v. Honda*,¹ the employee, a chronic fatigue sufferer, was enrolled in a disability program by his employer, Honda, that required him to submit a doctor's note for each absence. After numerous absences, Honda asked Keays to meet with an occupational health specialist. When he refused, his employment was terminated. The trial judge found that Keays had been wrongfully dismissed and awarded him 15 months' compensation in lieu of reasonable notice and an additional nine months' damages because the company had acted in bad faith in harassing him to provide medical information and attend medical appointments. Keays also received a very large award of punitive damages for harassment and discrimination.

The Supreme Court of Canada upheld the finding that Keays had been wrongfully dismissed. On the issue of bad faith damages, the Court held that it was not appropriate for courts to extend the notice period to compensate for harsh treatment at the time of dismissal. In Keays' case, the Court found there was no evidence of bad faith in Keays' termination because Honda's request for independent medical verification was a legitimate attempt to verify the nature and extent of Keays' disability. On the issue of punitive damages, the Court held there was no evidence that Honda violated Keay's rights because neither the disability program nor the requirement to bring a doctor's note were discriminatory; rather, the program itself represented an accommodation and the need to monitor the absences of employees who have a history of absenteeism was a bona fide work requirement. Accordingly, the court allowed the appeal and reduced the damages from 24 to 15 months' pay for wrongful dismissal.

The decision in *Keays* restores the rule that wrongful dismissal damages are calculated based on breach of contract. An employee seeking aggravated damages must show that the employer's action caused mental distress that was foreseeable by the parties. Attacking the reputation of an employee, falsely alleging cause for dismissal, or denying the employee a pension or other right would be examples of employer conduct giving rise to aggravated damages.

Constructive Dismissal

In the United States, an employee who is not employed at-will (in other words, an employee who works under an express or implied employment agreement) may bring a claim for constructive dismissal if his or her working conditions are so intolerable that a reasonable employee would be compelled to resign rather than endure such conditions. Essentially, a constructive dismissal transfers a resignation into an involuntary termination because the employee would not have resigned but for the employer's actions.

In Canada, a constructive dismissal also transfers a resignation into an involuntary termination. However, in contrast to the American meaning of "constructive dismissal," in Canada, a constructive dismissal occurs when an employee who is presented with a fundamental change to the terms of employment chooses not to consent to the change. Instead, the employee claims constructive dismissal. In other words, both countries treat constructive dismissal as a breach of contract, but the American view holds that the breach must be far more severe than the Canadian view.

A recent decision of the Ontario Court of Appeal considered whether an employer could implement a unilateral change to the terms and conditions of employment by giving the employee reasonable notice of the change.

In *Wronko v. Western Inventory Services Ltd.*,² Wronko had signed an employment contract when he was promoted to management that provided for two years' salary for termination without cause. The employer's new president considered the termination provision too generous and sought to reduce the payout to 30 weeks' salary. Wronko refused. The employer took the position that it could introduce the change with reasonable notice. Wronko was advised that the new termination provisions would come into effect in two years. Throughout the next two years, Wronko expressly rejected the proposed change and continued to work. After the two year notice period, the employer advised Wronko that the new termination provisions were in effect and that if he did not accept the new terms and conditions of employment, he would

be terminated. Wronko did not report to work the next day. He sued for constructive dismissal.

The court of appeal determined that the employer's attempt to change the termination provision through notice was ineffective. The Court observed that an employer seeking to substantially modify terms of employment can accomplish the objective if the employee is prepared to consent to the change. However, the employee is entitled to insist that the terms of a contract be fulfilled. In such a case, there are two possible outcomes. The employer may give notice of the change and face a claim of constructive dismissal from the employee who will not consent. Alternatively, the employer may give notice of termination of employment and offer the employee re-employment at the end of the period on the revised terms. By giving notice of termination, the employer avoids liability for constructive dismissal and is positioned to implement the revised terms of employment. While the decision is helpful in clarifying the law, many employers will be reluctant to alarm an employee or group of employees with notices of termination in order to modify a bonus plan, work schedule, benefit or other term of employment.

Previous case law had suggested that fundamental changes could be made on the provision of reasonable notice. *Wronko* affirms that employers should provide reasonable notice of fundamental changes but it also suggests that where an employee continues to object to the new term, the employer may need to provide notice that the employee's employment will be terminated at the end of the notice period and to offer the employee reemployment pursuant to the new terms and conditions of employment.

Restrictive Covenants

In the United States, the question of restrictive covenants is covered by state law and varies dramatically from state to state. For example, California and North Dakota expressly prohibit "noncompete" agreements (where the employee agrees not to compete with the employer for a period of time after the employee's employment ends). But other states allow such agreements and will enforce a restrictive covenant for several years after the employee's employment ends.

Many employers in Canada require employees to sign employment contracts that include restrictions on competition and the solicitation of customers and other employees. Canadian courts are generally prepared to enforce nonsolicitation provisions. However, restrictions on competition are generally unenforceable unless the restriction is reasonable and necessary to protect legitimate business interests. Further, what a Canadian court finds to be a reasonable restriction will generally have a shorter duration and cover a smaller geographic area than a restriction that an American court would find reasonable. A recent decision of the Supreme Court of Canada considered the circumstances in which an employer could rely on a noncompetition provision.

In *Shafron v. KRG Insurance Brokers (Western) Inc.*³ the Supreme Court of Canada held that ambiguous restrictive covenants in employment contracts are unenforceable. Shafron was employed by KRG Insurance Brokers and had signed a series of employment contracts containing a restrictive covenant that prohibited him from being employed as an insurance broker in the "Metropolitan City of Vancouver" for three years after leaving KRG Insurance Brokers. Shafron left KRG and began working with another insurance brokerage in nearby Richmond, British Columbia. KRG sought to enforce the terms of the restrictive covenant.

The Supreme Court of Canada reaffirmed that restrictive covenants in employment contracts are unenforceable unless they are reasonable in terms of geographic coverage, time, and the activity prohibited. The onus is on the employer to satisfy the Court that the restriction is reasonable. The Court in this case held that where the terms of the covenant are ambiguous, the terms cannot be demonstrated to be reasonable and will be void and unenforceable. In this case, the term "Metropolitan City of Vancouver" had no accepted meaning. The Court held that it is inappropriate to apply the doctrine of severance to clarify the terms of a restrictive covenant because employers would be encouraged to draft broad restrictive covenants with the expectation that courts will work to find the enforceable limit of the provision. The Court also noted that restrictive covenants in the context of a sale

of business will be subject to a less stringent standard of reasonableness than restrictive covenants in employment contracts.

Shafron reaffirms the reluctance of Canadian courts to enforce restrictive covenants in employment contracts. In order to be enforceable, the terms must not only be reasonable in geographic, temporal, and subject matter scope but also must be unambiguous. Any ambiguity will render the covenant void and therefore employers should exercise caution in drafting such covenants.

In contrast, some American courts likely would have come to a different conclusion. Most states allow a court to rewrite the terms of a restrictive covenant if the parties have included a clause allowing the court to do so. Other states (Arizona is an example) allow a court to strike out objectionable language but do not allow a court to add or rewrite the parties' language. Still other states (Georgia and Nebraska are examples) follow the Canadian approach and prohibit modifying the terms of an otherwise invalid restrictive covenant to make it enforceable.

Post-Employment Obligations

One area where the employment laws of the United States and Canada are in harmony is the duty of loyalty. Briefly stated, employees on both sides of the border have an implied duty to perform their duties in good faith and to be loyal to their employers. Restrictive covenants as discussed above are one way employers try to extend this duty of loyalty beyond the end of the employment relationship.

Recently, the Supreme Court of Canada considered what limitations apply to an employee's right to work for a competitor in the absence of a specific contractual restriction.

In *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.*,⁴ the Supreme Court of Canada held that departing employees are permitted to compete with their former employers during the reasonable notice period. In this case, nearly all of the employees at the RBC Dominion branch in Cranbrook, British Columbia quit their employment without notice and went to work for

Merrill Lynch Canada Inc. At trial, damages were awarded against the branch manager for the breach of the implied duty of good faith for failing to perform his employment duties in good faith by coordinating the mass resignation, participating in the disclosure of confidential files to Merrill Lynch and failing to give notice of his departure. Damages were awarded against all employees for failing to give reasonable notice of departure and loss of profit resulting from competition during the reasonable notice period. The court of appeal varied the damages awarded.

The Supreme Court of Canada disagreed on some points. The Court found that the branch manager owed RBC Dominion an implied duty of good faith in the exercise of his employment duties. The Court also found that he had breached this duty by arranging the mass resignation of employees and by providing, or participating in the provision of, confidential files to Merrill Lynch. However, the Court overturned the award for loss of profits made against all employees for competing during the reasonable notice period. The Court held that once an employee's contract for employment is terminated, the employee's duty of loyalty is at an end unless the employee is in a fiduciary relationship or there is a restrictive covenant in place. In these circumstances, the Court noted that an employer generally is limited to recovery of damages for failure to provide reasonable notice of resignation unless there is specific wrongdoing that an employee may be liable for, such as the misuse of confidential information.

The decision in *RBC Dominion Securities* establishes that absent fiduciary duties, which are stronger than the duty of loyalty, or a restrictive covenant, employees are free to compete against their former employers as soon as the employment relationship terminates even when the employee fails to give reasonable notice of his or her departure.

As noted at the outset, these decisions illustrate some of the similarities and differences between the nature of the employment relationship in Canada and the United States, respectively. In *Keays*, the Court limited the awarding of damages to losses arising from the actual breach of the employment agreement itself. Contrast that with the American "at-will" doctrine. In *Wronko*, we see

how a legal doctrine existing on both sides of the border – constructive dismissal – differs between the United States and Canada. In *Shafron*, we see that restrictive covenants in Canada must be properly drafted from the outset because courts will not rewrite them. Finally, *RBC Dominion Securities* shows that employees in Canada, just as in the United States, have an implied duty of loyalty while they are employed. Terminated employees, however, generally are not restricted from competing unless the employee is a fiduciary or has agreed to an enforceable non-compete provision.

- 1 2008 SCC 39, (2008), 66 C.C.E.L. (3d) 159.
- 2 2008 ONCA 327 leave to appeal to S.C.C. refused 2008 CarswellOnt 5913.
- 3 2009 SCC 6.
- 4 2008 SCC 54.