THE DEPARTING SENIOR EXECUTIVE

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COMMON LAW DUTIES OF THE SENIOR EMPLOYEE

A business places its trust in its senior employees. Indeed, those in senior or "key" positions have access to and control over some of the company's most valuable assets: confidential information such as trade secrets and customer lists, the goodwill the company has established (and/or paid for), and the company's developing or "ripening" future business opportunities. Due to such access, however, the company faces a substantial risk when a senior employee leaves. There is always the risk that the departing senior employee will take those assets and use them for self-interested purposes.

The courts recognize this risk. At common law it has long been understood that whenever one party depends or relies upon another there is the potential for self-interested abuse. In order to protect vulnerable parties, therefore, the courts have imposed what are termed "fiduciary duties" upon persons in positions of trust. It is well established in Canada that, directors, officers and senior executives ("senior employees") are in such positions and consequently owe fiduciary duties to the companies for which they work.

Of course, all employees owe obligations to their employer. However (and except for the disclosure or misuse of confidential information and absent an enforceable non-competition or non-solicitation agreement), when a regular employee leaves a company, these obligations come to an end. This is not the case with senior employees. Some of the duties attached to these higher positions continue beyond the employment relationship. The duties that endure are designed to ensure that senior employees do not take the company's protected assets with them when they leave.

The fiduciary obligations owed by senior employees, include the following.[1]

First, as with all employees, senior personnel may not disclose or use the confidential information of the company they have left. However, for information to be afforded legal protection it must be something "particular" to the company such as a confidential pricing system or customer list or a trade secret like a formula or production process. In other words, it must be something which the company has expended resources to possess and protect and in which, therefore, it holds a proprietary interest.[2] It does *not* include the skills, knowledge

1 See the Alberta Court of Appeal's decision in Physique Health Club Ltd. v. Carlsen (1996), 45 Alta. L.R. (3d) 383.

2 In order to succeed in an action for breach of confidence, normally three elements must be established: (1) the information must have been imparted in circumstances imparting an obligation of confidence, (2) the information itself must have the necessary quality of confidence about it; and (3) there must have been an unauthorized use of the information to the detriment of the party communicating it.

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or expertise that the employee has gained over the course of his or her employment, even if the skill, knowledge or expertise was acquired through employment with the former employer. Those belong to the employee alone and, barring an enforceable non-competition agreement, may be utilized at any time and anywhere. Information is protected by the courts where it was made clear to the employee that the information is confidential and has been treated as such by the employer. In considering whether information is confidential, the Court will consider whether the "circumstances are such that any reasonable man standing in the shoes of the recipient of the information would have realized that upon reasonable grounds the information was being given to him in confidence".[3]

Second, a departing senior employee may not take a business opportunity that was owned by the company or for which the company was in the process of negotiating during the employee's term of employment. This is particularly true if the employee was personally involved in the negotiations for that opportunity.

The restriction is negated, however, if the company was fully informed of the opportunity and refused it, or if the opportunity had lapsed and the employee then expended "fresh effort" in obtaining it after leaving.[4]

Third, and again unlike regular employees, senior personnel must not actively solicit an employer's customers, suppliers, or other employees after they leave (nor indeed before they leave if they do so in preparation for departure)[5]. Unlike the duty regarding confidential information, however, this obligation terminates after a "reasonable period" of time. Just what constitutes the "reasonable period" is open to argument. Generally speaking the courts base this determination on how long it should take the company to contact its customers and suppliers and (at least attempt) to retain its influence over them. As such, the period's length depends largely on the strength of the personal attachment between the departing employee and the customers and suppliers in question. The more contact the employee had with such people, the longer the period of non-solicitation.[6] Once the period is at an end, however, so too is the non-solicitation obligation and the customers and suppliers become fair game. While the Court, in setting the period of non-solicitation, will consider the reasonable notice period that would have been owed by the employer in the event of termination without cause, the two concepts are not interchangeable.[7] It should also be noted that

3 Coco v. A.N. Clark (Eng.), [1969] R.P.C. 41 at 48 as quoted in Tree Savers International Ltd. v. Savoy (1992), 87 D.L.R. (4th) 202 (Alta. C.A.)

4 For the leading case on "appropriation of a maturing business opportunity" and fiduciary duties in general, see Canadian Aero Service Ltd. v. O'Malley (1973), 40 D.L.R. (3d) 371 (S.C.C.). In that case, the former President and Vice-President had left the employ of Canadian Aero and through a corporate vehicle acquired a large surveying contract that they had previously pursued on behalf of Canadian Aero. The Court held that the fiduciary duties of directors and senior officers "disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired."

5 Alberts v. Mountjoy (1977), 79 D.L.R. (3d) 108 (Ont. H.C.J.); W.J. Christie & Co. Ltd. v. Greer (1981), 121 D.L.R. (3d) 472 (Man. C.A.); Anderson, Smyth & Kelly Customs Broker Ltd. v. World Wide Customs Brokers Ltd. (1996), Alta. L.R. (3d) 411 (Alta. C.A).

6 In Anderson, Smyth & Kelly Customs Broker Ltd. v. World Wide Customs Brokers Ltd., the Defendant Kelly had been employed for nine years and had been a director, officer and minority shareholder of the Plaintiff. The Court of Appeal held that the Defendant Kelly was refrained from soliciting clients for a period of one year after departure.

7 See: CRC-Evans Canada Ltd. v. Pettifer (1997), 197 A.R. 24 (Alta. Q.B.), affirmed (1998), 216 A.R. 192

a senior employee is not precluded from passively accepting the previous employer's customers and suppliers or from securing those customers as a result of a general solicitation of the marketplace; it is only active or direct solicitation that is prohibited. A fiduciary may also be found to breach his fiduciary obligations by soliciting employees or contractors.[8]

Fourth, as a traditional rule, a senior employee does *not* owe a common law obligation of non-competition with his or her past employer. Rather, the law starts from the premise that restrictions on competition are against the public interest as being in restraint of trade. In general, therefore, the courts' only concern with competition by senior employees is that it be "fair" or, in other words, that the employee does not compete by breaching the prohibition against the use of confidential infoimation, the taking of a business opportunity or the active solicitation of the company's customers, suppliers and employees.[9]

In *CRC-Evans Canada Ltd. v. Pettiftr*,[10] two senior employees, Pettifer, the Service Manager and Bohuch, the Sales Manager, were found to have breached their obligations of good faith and fidelity and their fiduciary obligations. Pettifer and Bohuch were the second and third highest paid employees in the company, next to the President. Pettifer gave two weeks' notice of resignation on March 19, 1991. By April 2, 1991, a couple of days after Pettifer's resignation had been in effect, Pettifer and Bohuch decided to form a company, Rocky Mountain, and to use American suppliers to compete directly with CRC-Evans. Bohuch was still employed with CRC-Evans at the time. Rocky Mountain started planning to bid on a project, the Union Gas project, that Bohuch had bid for CRC-Evans. Bohuch assisted Pettifer in preparing quotes and supplied infoiniation in order to obtain work on the Union Gas project. After Bohuch and Pettifer had made their agreement on April 2, Bohuch traveled to Hawaii to attend a pipeline construction company convention where his expenses were paid by CRC-Evans. While in Hawaii, Bohuch fed information to Pettifer by telephone that enabled Pettifer to make the competing bid. Rocky Mountain was the successful bidder on the Union Gas project. Bohuch advised CRC-Evans on April 16, 1991 that he was resigning effective immediately.

The Court found that Pettifer had been exploring competing with CRC-Evans during his employment. Furthermore, while employed with CRC-Evans, both Pettifer and Bohuch had traveled to Houston to meet with potential investors. The trial judge held that these actions were clear breaches of the duty of fidelity owed by both employees to their employer. Pettifer and Bohuch were also found to be fiduciaries. Pettifer and Bohuch were found to have breached their fiduciary obligations by planning, while still employed by CRC-Evans, to incorporate a competing business, solicit CRC-Evans customers and bid on projects that one of them had bid for their employer, by securing a project bid by CRC-Evans and by Bohuch disclosing infoimation for this bid to Pettifer so that Pettifer could directly compete. The Court set the period of non-competition as twelve months and awarded damages for projects lost by CRC-Evans to Rocky Mountain over that twelve-month period. While the Court talked in general terms of Pettifer and Bohuch's obligations not to compete with CRC-Evans, these statements should be interpreted as references to their general obligation not to compete unfairly with their former employer.

The obligations owed by fiduciaries are "strict"

(CA) where the Court held that while the reasonable notice period would have been between 15 and 18 months, the defendants were bound by their fiduciary duties for 12 months.

8 MacDonald (c.o.b. P&L Services) v. Klein [1998] O.J. No. 4922 (Ont. Gen. Div.)

9 Physique Health Club, supra. note 1

10 Supra, note 7

obligations. In other words, to establish a breach an employer does not have to prove that the employee acted with any malintent. Potential remedies include: an accounting by the employee for any profits gained through the breach, disgorging those profits, an injunction against future similar behavior and damages for any losses suffered.

Fiduciary obligations are not restricted to only those holding fonnal executive titles. Rather, it is the *substance* of the employment relationship that matters. As the purpose of the doctrine is to protect employers from an abuse of trust placed in their personnel, fiduciary obligations will apply to anyone who stands in that kind of position. In *Frame v. Smith*, the Supreme Court of Canada set out the following test for whether an employee is a fiduciary:

> (a) whether the employee has the scope to exercise some discretion or power;
> (b) whether the employee unilaterally exercises discretion or power to affect the company's legal or practical interests; and
> (c) whether the company is dependant upon or vulnerable due to the discretion or power held.[11]

Thus, not only CEOs, COOS, and CFOs or senior managers may be held accountable to the higher and more enduring fiduciary standards, but those found to be "key employees" may be caught by fiduciary obligations. This is an important protection for employers when key employees have developed a special relationship with the company's client base. Without a substance-based fiduciary test, those clients could be easily solicited away upon the key employee's departure.

While it should not be assumed that only a senior employee could be found to be a fiduciary, it should equally not be assumed that every employee in a senior position is a fiduciary.[12] The courts will examine each situation on its facts to determine whether the necessary circumstances of trust and vulnerability are present to support the finding of a fiduciary relationship.

Even those that are not fiduciaries may find themselves caught by fiduciary obligations. A junior employee, who is not otherwise a fiduciary, will be bound by fiduciary obligations the moment he joins with a fiduciary in competing unfairly with their former employer. In other words, once the junior employee joins with the senior employee, both are caught by the senior employee's fiduciary obligations.[13]

THE ADVANTAGES OF EXECUTIVE EMPLOYMENT CONTRACTS

A contract of employment exists whether or not it is in writing. However, there are advantages to employers and senior executives to having their respective obligations confirmed in a written executive employment contract. In the absence of a written contract, the employer and the senior employee run the risk that it will be the courts, not the parties, who will determine their respective rights and obligations.

11 Frame v. Smith, [1987] 2 S.C.R. 99.

12 In Ashdown v. Jumbo Video Inc., [1993] O.J. No. 1169 (Ont. Gen Div.), a General Manager was found not to be a fiduciary because he was neither a director or shareholder, he reported to the three chief officers and while he was consulted on major decisions he was not part of the inner circle of decision making. See: Dialadex Communications Inc. v. Crammond (1987), 14 C.P.R. (3d) 145 (Ont. H.C.J.) -National Sales and Marketing Manager not a fiduciary; R. W. Hamilton Ltd. v. Aeroquip Corp (1988), 65 O.R. (2d) 345 (Ont. H.C.J) - Sales Manager not a fiduciary.

13 Alberts v. Mountjoy, supra. note 5; Tree Savers International Ltd. v. Savoy (1991), 81 Alta. L.R. (2d) 325 (Alta. Q.B.), affirmed (1992) 87 D.L.R. (4th) 202 (Alta. C.A.)

The main advantages for an employer to having written employment contracts with its senior personnel are: greater certainty and understanding between the parties (thereby reducing the risk of costly litigation), the ability to bargain for terms and protections more favorable than would otherwise be implied at common law, potentially greater flexibility in the employment relationship, and, from a preventative standpoint, the ability to foreclose or limit certain legal actions against the employer.

The advantages for the senior employees are certainty (for example, oral promises are documented, short and long Willi perfoimance bonuses can be enumerated in detail), the ability to create teens that address the executive's unique circumstances or desires (for example, deferred compensation and sophisticated entitlements) and the ability to bargain for benefits or protections beyond those afforded under the common law (for example, payment of severance in a lump sum and avoiding the duty of mitigation, giving the executive the ability to define when a constructive dismissal has occurred and thereby trigger an automatic severance payment).

The more senior a prospective employee's position, the greater the level of responsibility and access to proprietary information, and the more complex the compensation arrangements, the more important it is for the parties to define their relationship through a written employment contract.

Employment contracts for senior executives are generally more complicated than employment contracts for employees in less senior positions (although they do not have to be more complicated). This greater level of complexity stems from the fact that the compensation arrangements for senior employees are generally more sophisticated and from that fact, the senior employees generally have greater bargaining power.

Employers frequently use employment contracts to define their severance obligations in the event of termination without cause. The advantages to employers of defining notice or severance obligations in a written employment contract are the following. First, by defining, in advance, what the severance teems will be, the employer is better able to assess and plan for the costs of dismissing an employee. Second, if the agreement is properly drafted the employee is less likely to bring an action against the employer which, of course, reduces the employer's legal costs. Third, the employer can reduce cost by negotiating a severance obligation that is less generous than the employee would otherwise obtain at common law (provided that the negotiated notice entitlement does not fall below the minimum notice provisions in the applicable employment standards legislation).[14] The courts will enforce contractual limitations on an employee's common law notice entitlement provided that the contract was entered into freely and without duress.[15]

The advantages of written executive employment contracts go far beyond defining or limiting severance obligations. Besides the benefits of written severance agreements, there are also advantages to executive employment contracts addressing the terms of a senior executive's obligations upon departure.

The most important use of executive employment contracts, from the employer's standpoint, is the ability to define the executive's obligations and to create obligations greater than those imposed by the common law.

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14 If the contractual notice period falls below the minimum notice provisions in the Employment Standards Act (Alberta), the contractual limitation is void and the presumption of reasonable notice remains. See: Matchinger v. HOJ Industries Ltd. (1992), 91 D.L.R. (4th) 491 (S.C.C.)

15 T.D. Bank v. Wallace (1983), 145 D.L.R. (3d) 431 (Ont. C.A.) at 450-451

In this regard, the agreement may define what constitutes "confidential information" in the specific context of that company's business. In this way, an employer could explicitly define which of its information is confidential (thereby reducing the risk that the information will not be found to be confidential) and make it clear to the executive and the court which of its information the employer considers confidential and wants to protect. In the absence of a written employment agreement there is a great risk that the court would narrowly define the employer's "confidential infonnation".[16] In the same way, the employer could define "just cause for termination" broader than under the common law in order to address the particular concerns of its industry or corporate culture.[17]

The executive employment agreement can bind an employee to fiduciary obligations or define those obligations. This way the employer can define the specified time period that solicitation of customers or employees is prohibited, rather than leaving it to the court to define this period. By making the employee's fiduciary obligations more certain the employer reduces the risk that a court will be asked to determine what those duties entail and whether there has been a breach. It also allows the employer to tailor those duties to the specific needs of the business. Furthermore, the employer can impose fiduciary obligations on employees who may not necessarily be fiduciaries or in circumstances where it is uncertain whether the employee is a fiduciary. Conversely, it is important that the executive employment agreement has been properly drafted so the employer has not unintentionally restricted the scope of the fiduciary obligations that are otherwise in place.

One of the greatest protections an employer can achieve through a written employment contract is prohibition of competition. At common law there is no prohibition against a senior employee engaging in "fair" competition. In many companies, however, it is the senior employees who the customers come to know, identify the business with, and to whom they are loyal. This personal connection may mean that a senior employee does not need to actively solicit customers to damage the company when departing. Rather, if that employee later engages in a similar business (whether for himself or others), the customers (and suppliers and employees) may themselves simply choose to follow. Without a written non-competition agreement in place, there is nothing an employer can do to prevent this from happening.

Non-competition agreements, as they relate to employees in general, have been already discussed during the course of this seminar. To briefly recap the principles, the starting point is that such clauses are unenforceable. Then, exceptions are made for those agreements considered "reasonable as between the parties" and which are not against the "public interest". In particular, the non-competition provision has to be reasonable as to time, scope and geography. It is important to note that what a court will consider "reasonable as between the parties" is affected by the position of the employee. The more connected the goodwill of the business is to the departing employee, the more "reasonable" an otherwise onerous non-competition agreement will appear to the courts.

This test for enforceability is laid out in the leading anadian case on employee non-competition clauses, *Elsley v. J.G. Collins Insurance Agencies*

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16 A confidentiality provision is a restrictive covenant. Consequently, the terms must be reasonable as between the parties and reasonable in reference to the public interest. See: Nordenfelt v. The Maxim Nordenfelt Guns and Ammunition Co. Ltd., [1984] A.C. 535 at 565 (H.L.)

17 It is important that the just cause provision is properly drafted to ensure that the employer has not unintentionally narrowed the common law definition of "just cause". It is important that the clause state that the definition includes events which would be found to be just cause at common law.

Ltd.[18] The Supreme Court of Canada stated that such clauses would be upheld (barring those against the public interest) when the foinier employee was "in a position where he acquired a close personal acquaintance with the clients or customers of the business." Accordingly, the courts will enforce non-competition agreements when the employee had "special and intimate knowledge of the employer's customers and the means to influence them." This is particularly true in cases where, like in *Elsley*, the employee had formerly owned the business. It is recognized that in such situations the vendor-turned-employee will likely be highly identified with the company in the eyes of its clients. It is also recognized that no buyer would likely be found in the absence of some prohibition on the seller from starting up a competing business. Consequently, non-competition covenants for periods as long as five years have been upheld in the context of a sale of business.[19]

In the absence of a sale of business, there is another factor that makes non-competition clauses against senior employees somewhat easier to defend. Employment contracts are generally scrutinized carefully by the courts in a manner biased towards employees. This is due to the courts' general concern about the imbalance of bargaining power between employers and their personnel. This judicial concern is lessened somewhat when reviewing an employment contract entered into by a senior executive. As noted in the 1996 Ontario case of *Woodward v. Stelco*,[20] employment contracts with senior employees are generally agreements between "two sophisticated and experienced parties." As such, the likelihood of duress is greatly reduced and, therefore, so too is the judicial bias against enforcing contractual terms unfavourable to the employee.

18 (1978), 83 D.L.R. (3d) 1 (S.C.C.).
19 Doerner v. Bliss and Laughlin Industries (1980), 117 D.L.R. (3d) 547 (S.C.C.).
20 (1996), 20 C.C.E.L. (2d) 70 (Ont. Gen. Div.).

Lastly, an employment contract may give the employer the ability to alter Willis and conditions of employment in order to respond to changed business conditions without triggering a constructive dismissal. As a result, a written employment contract can provide the employer with the ability, its absolute discretion to change job title, responsibilities and reporting structure or the right to transfer the employee to other company locations. If the employer's bargaining position permits, it is even possible, albeit rare, to provide the employer with the right to decrease remuneration or benefits.

ENFORCEABILITY OF THE WRITTEN EMPLOYMENT CONTRACT

Once an employer has taken the time, gone to the expense and effort to put an employment contract in place, it is important that the contract be kept current.

Otherwise, there is a risk that a court may find that the contract had lapsed over time and is no longer enforceable. This concern relates largely to departing senior employees who signed an employment contract at the commencement of their employment and have subsequently risen through the ranks. When an employee has risen in the company it can be argued that the "substratum" of the initial entry contract is either gone or eroded to the point that the contract is no longer in force. In the Ontario Court of Appeal decision, *T.D. Bank v. Wallace*[21] (known for laying down the principle), the contract was upheld. In determining that result, however, the court stated that:

> Certainly there are readily imaginable cases where an employee's level of responsibility and corresponding status has escalated

21 supra note

> so significantly during his period of employment that it can be concluded that the substratum of an employment contract entered into at the time of his original hiring has disappeared, or it can be implied that that contract could not have been intended to apply to the position in the company ultimately occupied by him.[22]

There are certain strategies that an employer can take to minimize the chance that a court could find that there had been an "erosion of the contract's substratum". First, an employer should try to avoid placing specifics of the employee's job position into the agreement or specifying the employee's salary and benefits.[23] Second, the employer should draft the agreement to explicitly reflect the contemplation that the employment relationship will likely alter over time and that it is the parties' intention for the contract to remain valid regardless of those alterations.[24] Third, it is good practice to re-execute the contract over time so as to adequately reflect the employee's position and remuneration. There appears to be a point at which the courts will detettnine that, absent tangible evidence that the employee truly intended otherwise, the contract could not possibly have been meant to still govern the relationship. This point appears to be most readily found where an employee has started in the lower or middle ranks of a company's personnel, and then progressed to the upper ranks of responsibility and pay by the time of departure.[25] Fourth, the best time to reexecute a new contract is when an employee is being given a promotion or a raise or other significant benefit. Executing the contract at this time will also permit the employer to defend the contract, in the future, on the basis that the employee received proper consideration for the new employment contract. If an employment contract is entered into after the employment relationship had commenced, the contract should document the consideration received by the employee (for example, a raise in salary, promotion, enrolment in a bonus or stock option plan, etc.) for exercising the contract. Otherwise, there is a risk that a court may subsequently rule that the contract was unenforceable due to absence of consideration.[26]

While employees bound by employment contracts may challenge the enforceability of the contract on the basis of unconscionability, there are also cases where employers have sought to avoid severance obligations with senior employees on the basis that they were unconscionable or constituted a penalty.

In *Ashdown v. Jumbo Video Inc.*[27] a three term contract provided that the employee was entitled to 18 months remuneration in the event of termination. The company was sold and the new employer sought to avoid the severance payment under the contract after termination of the Plaintiff's employment. The Court rejected that argument that the severance payment constituted a penalty and questioned the applicability of the commercial law on penalties to an employment contract. The Court also found no evidence of duress, fraud or inequality of bargaining position and stated:

> "Where a contract has been negotiated openly, fairly and in good faith, and in the absence of unconscionability, I find that the court should not intervene to rectify an extravagant or foolish contract."

In comparison, the Saskatchewan Court of

22 Supra. note at p. 451
23 Sharpe v. Computer Innovations Distribution Inc. (1993) 1 C.C.E.L. 2d) 28 (N.B.Q.B.), affd (1994), 2 C.C.E.L. (2d) 157 (C.A.); and Sawko v. Foseco Canada Ltd. (1987), 15 C.C.E.L. 309 (Ont. Dist. Ct).
24 The contract in Waddell v. Cintas Corporation, [1999] B.C.J. No. 2404, was upheld on this basis.
25 Sharpe v. Computer Innovations, supra. note
26 Watson v. Moore Corporation Ltd., [1996] B.C.J. No. 525 (B.C.C.A)
27 Ashdown v. Jumbo Video Inc. [1993] O.J. No. 1169 (Ont. C.J.)

Queen's Bench, in *Zielinski v. Saskatchewan Beef Stabilization Board*[28], held that a lump sum retiring allowance equal to 2.5 times the annual remuneration of the employee was unconscionable in amount in comparison with the greatest loss that could be conceivably proved. The employment contract had provided for termination upon 90 days' notice in which the following benefits were triggered: payment of a lump sum retiring allowance equal to 2.5 times the final annual remuneration of the employee, payment into the pension plan of such portion of the retiring allowance as directed by the employee to attain 25 years of contributory pension service with the Public Service of Saskatchewan and Canada, continuation for a period of 18 months of his employment benefits, including, disability, medical, dental and life insurance, relocation counseling services and all costs associated with relocating. The Court found, on construction of the agreement, that these benefits had not been triggered despite the employee's termination. The Court also found that the clause in question constituted a penalty and was, therefore, unenforceable.

WRONGFUL DISMISSAL REMEDIES FOR DEPARTING SENIOR EXECUTIVES

Severance packages and damage awards are generally greater for senior employees and, therefore, more expensive than for employees in lower positions. The increased cost is a function of the notice periods awarded by the courts to senior employees and the generally more sophisticated compensation packages provided to employees in these positions.

The courts typically allot senior employees longer notice periods than regular employees even when other relevant factors such as age and duration of employment are the same. The courts accept that senior positions with high responsibility and pay are fewer and, therefore, it will take senior employees longer to find satisfactory alternate work. Furthermore, if the employer is found to have breached its obligation of good faith and fair dealing in terminating the employee, the court may extend the notice period through a *Wallace* bump-up.[29]

When an employer does *not* provide reasonable notice or payment in lieu, and in the absence of written contractual provisions negating[30] or limiting the employee's right to such notice, he or she may ask the court to assess what the period should have been and award damages for it. The general rule as to damages is that the court will endeavour to place the employee in the position he or she would have occupied had the contract been performed. In other words, damages are assessed on the basis of what the employee would have received in compensation for service throughout the reasonable notice period.

The compensation awarded is not merely salary. Rather, it includes all commissions, bonuses, benefits, and perquisites that the employee would have normally had a right to during employment. Consequently, the cost of dismissing a senior executive can be substantial. Senior executives will likely claim damages for lost bonus, incentive payments, stock options, pension enhancements or entitlements and for loss of benefits like the company car or vehicle allowance, business, health or social club memberships, professional

28 Zielinski v. Saskatchewan Beef Stabilization Board (1992), 42 C.C.E.L. 24 (Sask. Q.B.), affirmed [1993] S.J. No. 643 (Sask. C.A.)

29 The Supreme Court of Canada, in Wallace v. United Grain Growers Ltd. (1997), 152 D.L.R. (4th) 1, held that employers are bound by a duty of good faith and fair dealing in the manner of dismissal, a breach of which is compensated by the court increasing the notice period. This increase has been described as the "Wallace bump-up".

30 Notice of termination is not required when an employer fails to renew a fixed term contract.

dues, conference fees, employment insurance benefits and pension contributions. Damages have also been awarded for lost employment insurance premiums, Canada Pension Plan contributions and residential accommodation and for moving expenses and capital loss on real estate. In addition, punitive or aggravated damages may be sought.[31]

An employer may be faced with other actions, in addition to wrongful dismissal, as a result of dismissing a senior employee. Departed senior employees have brought actions, in tort, for defamation,[32] deceit,[33] negligent misrepresentation,[34] intentional infliction of nervous shock,[35] and interference with contractual relations.[36]

Employees have brought an action for interference with contractual relations or inducing breach of contract against officers of the company or fellow employees, personally. In order to establish this cause of action, the following elements must be established:

1. a valid and enforceable employment contract;
2. an awareness by the Defendant of the existence of the contract;
3. a breach of the contract procured by the Defendant;
4. such breach being effected by wrongful interference on the part of the Defendant; and
5. damages suffered by the plaintiff as a result.[37]

In *Simpson v. Consumers Assn. of Canadian*[38] the former Executive Director had been terminated for sexual harassment and other oppressive behaviour towards female staff. The Court held that the legal advisor for the employer had failed to fairly inform the President about the full and true facts surrounding her relationship with the Plaintiff and that when she imparted this information she knew or ought to have known that the information would tip the scales and result in his termination. The legal advisor was found jointly and severally liable with the employer for the wrongful dismissal.

The tort of defamation arises when a person's private, professional, trade or business reputation has been disparaged. To establish the claim before a court, a plaintiff must show that the statement in question was actually made and that it tended to lower the person "in the estimation of right-thinking members of society generally." If this is shown, it then rests with the defendant to prove that the statement was true. If the truth or "justification" of the statement cannot be proven, and a defence like qualified privilege is not available, the defendant can be found liable.[39] As a cautionary measure, employers should be circumspect in what they publicly say about employees while dismissing them and after. This is particularly true when an employer is alleging employee misconduct, such

31 Aggravated damages are compensatory and are awarded to compensate for harm suffered, for example, mental distress. The purpose of punitive damages is to punish. In order to support an award of aggravated or punitive damages, the court must find an independent actionable wrong; that is, a wrong separate from the dismissal itself. See: Wallace v. United Grain Growers Ltd. (1997), 152 D.L.R. (4th) 1 (S.C.C.)

32 *Ahmad v. Ontario Hydro* (1993), 1 C.C.E.L. (2d) 292 (Ont. Gen. Div), affirmed [1997] O.J. No. 3047 (Ont. CA.)

33 *Dixon v. British Columbia Transit* (1995), 13 C.C.E.L. (2d) 272 (B.C.S.C.), additional reasons at (1995), 15 C.C.E.L. (2d) 290 (B.C.S.C.)

34 Queen v. Cognos Inc. (1993), 99 D.L.R. (4th) 626 (S.C.C.); Roy v. B.N.P.P. Regional Police Commission (1986), 15 C.C.E.L. 167 (N.B.Q.B.)

35 Bogden v. Purolator Courier Ltd. (1996), 19 C.C.E.L. (2d) 77 (Alta. Q.B.)

36 *Ahmad v. Ontario Hydro*, supra. note 32; Simpson v. Consumer's Assn. of Canada (1999), 41 C.C.E.L. (2d) 179 (Ont. Gen. Div); Martin v. International Maple Leaf Spring Water Corp. [1998] B.C.J. No. 1663 (B.C.S.C.)

37 *Posluns v. Toronto Stock Exchange*, [1964] 2 O.R. 547 (Ont. H.C.) affirmed [1966] 1 O.R. 285 (Ont. C.A.)

38 *Simpson v. Consumer's Assn. of Canada (1999)*, 41 C.C.E.L. (2d) 179 (Ont. Gen. Div.); See also: Martin v. International Maple Leaf Spring Water Cotp. [1998] B.C.J. No. 1663 (B.C.S.C.)

39 *Ahmad v. Ontario Hydro* supra. note 32

as theft, dishonesty or conflict of interest. If it later turns out that the employer does not actually have cause, its prior assertions of cause, if publicly expounded, could be found to have been defamatory. A claim for defamation is more likely to be brought by a departing senior employee because of the importance of reputation and the relatively fewer available positions at that level.

In *Martin v. International Maple Leaf Springs Water Corp.*, the Plaintiff had been employed for nine months in a senior marketing position. His employment was terminated at a meeting of the Board of Directors when the President alleged that the Plaintiff had registered trades names for his own purposes and of dishonesty in other transactions. After termination, the President advised persons outside the company that the Plaintiff had been dismissed for dishonesty and that during his employment had come to work under the influence of alcohol. The Court found that while the Plaintiff had registered the trade names in his own name, he was holding them on behalf of the company and that the President had knowledge of these registrations at the time they occurred. The Court determined that there was no reasonable basis for alleging that the Plaintiff had come to work under the influence of alcohol or had a drinking problem. The Court assessed the reasonable notice period at six months and awarded an additional three months as a *Wallace* bump-up for a total of nine months. The Court awarded $25,000 in damages personally against the President for inducing breach of contract. The Court held that, but for the President's interference, there was a strong possibility that the Plaintiff would have remained employed indefinitely. Finally, $35,000 was awarded for punitive damages due to the wrongful accusation of dishonesty and misuse of alcohol. The defamation was the independent actionable wrong that resulted in the punitive damages award.

In *Queen v. Cognos Inc.*,[40] a prospective senior employee was not told at his interview that the position applied for was subject to funding. He accepted the job and started employment only to discover a few months later that the position he was hired for was not going to exist. He sued the employer for the negligent

misrepresentation of its manager at the hiring interview. The Supreme Court of Canada set out the test for negligent misrepresentation as follows:

a. there must be a special relationship between the parties (which the employment relationship satisfies);
b. the representation was untrue, inaccurate, or misleading;
c. the representor was negligent in making the representation;
d. the representee reasonably relied on the representation; and (e) because of that reliance, the representee suffered some damage.

Based on the facts in *Cognos*, the employer was found liable for negligent misrepresentation. In reaching that decision, however, Justice Iaccobucci stated that while the existence of a contractual relationship does not necessarily preclude suing in tort, that does not make the contract irrelevant. Rather, the contract may have the effect of negating an action in tort altogether, or limiting or excluding a particular tort such as negligent misrepresentation. In other words, an employer could contract with the employee so that the risk of such actions are reduced or, possibly, eliminated completely.

For example, in the recent Alberta Queen's Bench case of *Beadall v. Chevron Resources Ltd.*,[41] the

40 (1993), 99 D.L.R. (4th) 626 (S.C.C.)
41 (1999), 45 C.C.E.L. (2d) 26 (Alta. Q.B.)

Plaintiff had taken a leave of absence to pursue her engineering degree. Upon completion, however, her employer did not have a position for her. The Plaintiff brought an action, claiming that the company had negligently misrepresented that work would be available for her upon her return. The court denied the action. Specifically, the trial judge found that the employer's leave of absence follns contained a clause stating that no guarantee of employment upon return was being made. Since the Plaintiff had been aware of the clause and had signed the form, the misrepresentation claimed could not be made out.

Consequently, a properly drafted written employment contract may preclude a claim for negligent misrepresentation.

GOLDEN PARACHUTES AND GOLDEN HANDCUFFS

Golden parachutes were developed in response to the 1980s frenzy of corporate take-overs. These agreements can be controversial because of the size of the payout and the circumstances under which they were entered into. Golden parachutes have gained greater notoriety recently as shareholders or the successors to the employer have challenged these agreements in order to avoid the large payouts.

A golden parachute provides the senior executive with the option to leave and accept a large, generous severance package in the case of one or two "triggering events". In a "single trigger" agreement, the executive can invoke the right to receive a lump sum payment in the event of a "change in control" (typically defined by a change in majority shareholder or membership of the board of directors) of the company. In a "double trigger" agreement, the triggering event is a change in control and a "significant event" (usually a change in the nature of the executive's position and/or remuneration amounting to a constructive dismissal). Since the executive is the one who pulls the trigger, the employee generally views the single trigger as more desirable.

Proponents of golden parachute agreements state the benefits as these. First, they help attract top personnel to companies ripe for take-over. Such companies are generally undervalued as they have been poorly managed. Thus, they require strong and capable executives to turn the situation around. However, in the face of possible take-overs good people may be hard to get. Those employees will seek out opportunities with greater security. Golden parachutes provide them with that security.

Second, it is argued that the security golden parachutes allow executives to objectively concentrate on what is best for the company. An executive who will be taken care of "either way" will be more open to considering the benefits to the business of a "white knight" change in control. Conversely, an executive who is not worried about his or her position is not as likely to fawn over a potential new employer. Rather, that executive may be more willing to aggressively challenge a "black knight".

Third, it is argued that golden parachutes provide a valid defensive strategy against take-over bids. A potential corporate raider is less likely to swallow a company if it must also swallow the bitter pill of having to pay out large severance packages. It is this proposed advantage, however, that has most often come under attack. Since golden parachutes discourage take-over bids, a major rejection of golden parachutes is that shareholders can be denied the benefits of what would have been a good deal. Pursuant to this argument claims by shareholders have been advanced under legislative provisions such as section 234 of the *Business Corporations Act (Alberta)*, the section precluding acts of shareholder oppression. Additionally, arguments have also been made under provisions such as section 117 of the *Business Corporations Act*, the section which demands directors and officers act in the best interests of the company rather than their own.

The courts are generally deferential to decisions made by senior executives in the course of managing their corporations. Still, when an executive brings an action to have such an agreement enforced the courts will look closely at the situation. The judicial test for determining the validity of these contracts is whether it is reasonable and fair with regards to the business circumstances surrounding its creation and approval. For example, in *Cannaday v. McPherson*, an executive had taken a position with the company when it was in trouble and he had worked for considerably reduced remuneration for several years. In these circumstances, the B.C. Court of Appeal upheld an agreement that required the company to pay the Plaintiff the equivalent of 10 years salary plus benefits as being reasonable compensation in return for such consideration.[42]

The courts have also stated that golden parachutes used explicitly to discourage take-over bids may be upheld if the directors truly believed that such manoeuvering was in the best interests of the company. They are valid if created for a "proper purpose". In *Rooney v. Cree Lake Resources Corporation*, the test for propriety of purpose was stated as being:

a. that the directors truly perceived a threat;
b. that they acted only after proper investigation of that threat; and
c. that the means were reasonable given the nature of that threat.[43]

Despite the acceptance in *Rooney* of the validity of this motive, however, the court refused to enforce the agreement in question. Rather, since the golden parachute would have stripped the company of more than 70% of its assets, the judge deteirnined that the purpose could not have been in the best interests of the company. Indeed, it was an improper "waste" of corporate assets.

When considering whether to implement golden parachute agreements an employer should consider how valuable or necessary an employee would be during take-over negotiations. In other words, they should ask themselves whether the pay-out is truly worth keeping the employee in such an event. Further, they should consider whether they wish the executive to have the option of taking the package even if the take-over is "friendly". Often the new majority board of directors is willing to keep the executive on in the same position at the same salary. However, if the parachute can be triggered by only a change in control, the executive can unilaterally decide to take the severance package and leave. Consequently, from the stand point of the corporation, a "double trigger" agreement is preferable.

Finally, if an employer wishes to ensure that a golden parachute is enforceable they should ensure that it reflects the value of the employee to the business. The recitals to the employment contract should explain in detail the valid business reasons for entering into the contract (why it is in the best interests of the company and its shareholders). The payment made under the golden parachute should bear a reasonable relationship to the company's total assets and the executive's total compensation. Moreover, it should also be consistent with the policies of the company and the industry within which it is situated. A golden parachute is more open to challenge as unreasonable, the broader its definition of "change in control" and where the executive can unilaterally terminate his or her own employment following a change in control (a single trigger). The potential enforceability of

42 (1998), 44 B.C.L.R. (3d) 195 (C.A.).
43 (1998), 40 C.C.E.L. (2d) 96 (Ont. Gen. Div.); and see also 347883 Alberta Ltd. v. Producers Pipeline Inc. (1991), 80 D.L.R. 4th 359 (Sask. C.A.).

the golden parachute is enhanced where the executive provides additional compensation to the company in exchange (for example, a non-competition or non-solicitation of customers and employees covenant, or agreement not to resign for a minimum period of time). It is also prudent to have an independent committee of the company's board of directors or the company's shareholders approve the golden parachute when it is put in place.

Golden handcuff agreements, on other hand, are designed to ensure that senior executives (and other key personnel) remain with the company for an extended, specified period of time. These agreements operate through various schemes but generally offer deferred compensation payable only upon completion of a specified period of service or upon retirement. The advantages to such plans are that: they offer the company greater certainty in planning (by knowing that its management will not continuously change), they may engender greater loyalty (hopefully maximizing effort and perfounance), and they ensure that the knowledge and expertise senior employees possess will be retained (the importance of which has already been discussed).

There is another advantage unique to the "retirement scheme" versions of such agreements. They typically provide for generous pension benefits in return for non-competition promises. As previously noted, the ability to restrain top personnel from engaging in competition with the company can be of extreme value to the business. It is these employees who can do the most damage. Also, if a retired employee is not engaged elsewhere in the industry, they are more likely to be available for consulting duties with the previous employer.

Arguments against implementing golden handcuff agreements can be similar to those against golden parachutes: the company is not getting a benefit commensurate to the value of what it is paying out. Indeed, while such agreements are intended to retain and reward loyal employees, they may create a tendency to "coast" in a position in which the employee is no longer happy. Further, tenninating an employee with a golden handcuff agreement can be problematic. Under the common law, the employee could claim damages for the lost opportunity of having to leave before the end of the agreement. Finally, the company may unintentionally undermine the morale of key employees if the golden handcuffs are offered to some employees and not others, or the benefits are stratified so that some receive greater remuneration in the end than others. An employer should consider these potentially negative side-effects before deciding whether a golden handcuff agreement is appropriate.

Because of the complexity of golden parachute and golden handcuff arrangements, it is important that the terms of these agreements be fully set out in an executive employment contract.

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