

CASE IN POINT: WRONGFUL DISMISSAL AND FIDUCIARY DUTIES

Wrongful dismissal may terminate duty

BACKGROUND

What is a fiduciary employee?

Confidential business information and client relationships are key assets of any business. An organization's continued success is contingent on its ability to protect such assets.

Employees have obligations to act in the best interests of their employer as well as a duty of "good faith" or "fidelity." In certain circumstances an employee's duties will even survive the termination of the employment relationship. These duties can be pursuant to an employment contract, express or implied confidentiality obligations or by reason of being in a "fiduciary" relationship with the employer.

Determining whether an employee is a "fiduciary" is not always easy. Depending on the circumstances it may include members of the board of directors, top management, employees with direct and personal contact with clients or other key personnel of the business. Fiduciaries hold positions of trust and confidence and have the discretion to act in a way so as to affect the employer's interests substantially.

Because of the significance of their positions and the degree of potential vulnerability of the employer to fiduciaries, courts have imposed obligations on such employees over and above those owed by other employees. These obligations exist whether or not there is an employment contract. A fiduciary cannot, for a reasonable period of time after the cessation of her employment (typically, up to one year afterwards): directly solicit away the employer's clients or employees; seize corporate opportunities which are available to the employer; or act in any way in conflict with the best interests of the former employer.

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preventing the employees from carrying on the competing business or dealing with Zesta's clients or information.

The court dealt with the just-cause allegation first. It determined the employees' activities in setting up a competing business and in soliciting clients took place after the date of their termination. As a result there was no improper conduct while they were employed and, therefore, no just cause for dismissal. The court also determined the manner of termination was unfair and Zesta's treatment of some of the employees was "shameful." This warranted an award of additional and aggravated damages.

Having dealt with the damages award for severance, the court then considered the employees' fiduciary duties. It determined a wrongful dismissal without just cause and without notice in these circumstances constituted a total repudiation of the employment relationship. According to the court, by its actions, the employer extinguished all express and implied employment terms including an employee's fiduciary duties. The court said (at para. 315):

"Considering that (the employees) spent their whole careers of 21 and 19 years, respectively, building up the Zesta business only to be terminated with no source of income appears to me to be grossly unfair. In my view their fiduciary duty should have been wiped out and they should have been able to compete head-to-head with Zesta without any

The case: *Zesta Engineering Ltd. v. Cloutier* (2001), 7 C.C.E.L. (3d) 53

The duration of fiduciary duties — and the resulting protection available to employers — may have been altered by a recent decision of the Ontario Superior Court of Justice, *Zesta Engineering Ltd. v. Cloutier* (2001), 7 C.C.E.L. (3d) 53.

In *Zesta* the court determined the wrongful dismissal of a fiduciary employee simultaneously terminated all fiduciary duties owed following the wrongful termination, leaving the employee free to compete head to head without any consequences.

This case raises the stakes for employers in dismissing a fiduciary employee by exposing the employer to sig-

nificant risk of business harm and loss of ability to protect information and corporate opportunities in the event of a termination without just cause and reasonable notice. This risk is over and above the financial costs of the severance payable to the employee.

In *Zesta* the court was faced with a claim by the employer, Zesta Engineering Ltd., against several former senior management employees. Zesta terminated their employment alleging just cause because the employees were in the process of setting up a new company in direct competition with it, soliciting Zesta's clients and using confidential information — all while on Zesta's payroll. On the basis the employees were key fiduciary employees with direct client responsibilities, Zesta sought and obtained an interlocutory injunction pending trial

Continued on page 2975

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Take care when dismissing fiduciary employees

There is a lesson to be learned here. Where an employer dismisses an employee in a grossly unfair manner the employer may also be putting an end to all fiduciary obligations otherwise owed to it. Pending further judicial clarification employers are at significant risk in the event they dismiss fiduciary employees without just cause or reasonable notice.

When an employer seeks to restrain an employee's conduct, whether pursuant to an express restrictive covenant or by reason of fiduciary duties, the courts will take into account equitable considerations including whether either party breached the employment contract. If the employer wrongfully or constructively dismissed the employee, it does not sit well with the courts to also preclude re-employment in the industry. An employer that pays severance during the period of restricted activity will be better positioned to seek an injunction.

COMMENTARY


Risk may be minimized by adopting some basic steps:

- An employer should be careful before alleging just cause for dismissal and should do so only where the circumstances are abundantly clear. Otherwise there is a risk of increased severance and aggravated damages as well as exposure to competition and solicitation by former fiduciary employees.
- Prior to dismissing any fiduciary employee, an employer should assess the potential harm the employee could bring to the business if she competes with the business, solicits customers or seeks to usurp other business opportunities. Rather than alleging just cause or providing a lowball severance offer, an employer may be better advised to offer reasonable severance arrangements which include an acknowledgment of certain fiduciary obligations or express restrictive covenants. If an agreement as to severance cannot be obtained, con-

sider gratuitous payments (even without a release) for a reasonable duration.

- Document the parties' expectations, including the employee's restricted activities both during and subsequent to the termination of employment, in a fair employment contract. Such a contract could include reasonable restrictive covenants (non-competition and non-solicitation of clients and other personnel) and protection of confidential information.

- Seek professional advice before initiating any termination of employment. A well-communicated dismissal and fair severance arrangements may pre-empt improper employee conduct.

- An employer must treat its workers honestly and with decency throughout the relationship and continuing even through the termination process. If there is some evidence of a lack of good faith or fair dealing, courts will be inclined to intervene in the employee's favour. 

— Joe Conforti

Courts discourage high-handed and unfair conduct

...continued from page 2974

consequences."

The court reiterated fiduciary obligations are imposed by equity. Any employer who is seeking an equitable remedy must "come to the court with clean hands." Consequently the court lifted the injunction and permitted the dismissed employees to carry on in competition with Zesta without restriction. The court even awarded additional damages to the employees to compensate them for having been prevented for several months from conducting business as a result of the initial injunction.

In the end the court weighed heavily in favour of individual rights and in a manner to discourage high-handed and unfair conduct in the course of a termi-

nation of employment. This parallels recent judicial confirmation of the importance of the right to work and in maintaining an individual's livelihood. The central societal importance of the status of being an employee was confirmed by the Supreme Court of Canada in *Machtinger v. HOJ Industries Ltd.* (1992), 91 D.L.R. (4th) 491 (at p. 507):

"Work is one of the most fundamental aspects of a person's life, providing the individual with a means of financial support and, as important, contributory role in society. A person's employment is an essential component of his or her sense of identity, self-worth and emotional well-being."

It should be noted the Ontario Court of Appeal set aside the trial judgment in *Zesta* and ordered a new trial on the basis of

fresh evidence which was not initially available to the employer. The appeal court did not, however, comment on the manner in which the trial judge dealt with the fiduciary duties owed by the former employees. Moreover the principle in *Zesta* has been recently applied by another recent decision of the Ontario Superior Court of Justice, *Gestion Trans-tek Inc. v. Lampel* [2001, O.J. No. 1206. In that case the court stated fiduciary obligations arise as a result of "some mutuality of duty; that is to say that some responsibility on the part of the employer ... must also exist to act reasonably, fairly and appropriately in their dealings." According to the court any "precipitous" or abrupt termination of employment without just cause would also terminate any of the employee's fiduciary duties. 