
WRONGFUL DISMISSAL

Does a Wrongful Dismissal Terminate Post-employment Fiduciary Duties or Restrictive Covenants?

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As a result of the potentially devastating economic and personal effects of the loss of a job on their employees, the law imposes on employers a positive legal duty of good faith and fair dealing in the manner of conducting any termination of employment.

In reliance of this principle, substantial additional severance or even punitive damages may be awarded should an employer deal with its employment dispute in "bad faith." A typical example, viewed by the courts as a "hardball" intimidation tactic in litigation, is an unfounded allegation by employers of just cause for dismissal or other employee misconduct combined with a refusal to provide appropriate notice of termination or severance pay.

Employers engaging in such bad faith conduct should obviously be mindful of the possibility of increased court awards. However, this is not the only risk; rather, the misconduct may also free a dismissed employee from his or her fiduciary obligations or other restrictive covenants, thereby permitting that employee to compete without restriction against the employer – a potentially far more costly result.

Duties of a Departing Employee

Certain employee duties may survive the termination of the employment relationship. These continuing obligations include:

- *Restrictive Covenants:* Employment contracts often contain explicit provisions restricting an employee's post-employment conduct, including non-competition (preventing the departing employee from competing with the former employer, either by joining the competition or by establishing a competing business), non-solicitation (providing that the departing employee cannot solicit the former employer's clients or employees), or confidentiality (protecting from disclosure all proprietary confidential information and trade secrets before and after termination of employment).
- *Fiduciary Duties:* Certain senior employees have fiduciary obligations to act in the best interest of their employer during employment and continuing for a reasonable duration after the termination of their employment, even in the absence of a written employment contract. Fiduciary employees are those senior personnel who hold positions of trust and confidence and possessing the discretion to act in a way so as to affect substantially the employer's business interests. This category generally includes members of the board of directors and senior management, together with employees with direct and personal contact with customers. Although even a fiduciary is entitled, immediately after ceasing employment, to establish a business in direct competition with his or her former employer, a fiduciary employee cannot, for a reasonable duration (generally extending up to one year): directly solicit away the former employer's clients or employees; usurp corporate opportunities which are available to the former employer; or act in any way in conflict with the best interests of the former employer.

The Effect of a Wrongful Dismissal on a Departing Employee's Obligations

If an employer breaches the contractual terms of the employment relationship by wrongfully dismissing its employee, courts have consistently determined that, absent unambiguous terms to the contrary, that employer is disentitled from enforcing the restrictive covenants contained in any employment contract. This is based on the rationale that an employer cannot expect to

bind an employee to restrictive terms in an employment contract where the employer itself refuses to be bound by the contract.¹ The practical effect is that any non-competition clauses will cease to have any legal force upon a wrongful dismissal.

Similar factors come into play when an employer seeks an injunction in order to prevent a departing employee from competing or otherwise breaching a restrictive covenant. In such circumstances, courts will take into account equitable considerations which might weigh for or against the granting of an injunction, such as whether the employer is in breach of the employment contract. For example, if the employer has wrongfully or constructively dismissed the employee, it does not sit well to also preclude re-employment in the industry. Injunctions in such circumstances are extremely difficult.²

As a result of recent case law, it is likely that these principles and the limitation on an employer's remedies, will also apply to obligations owed by departing fiduciary employees.

In *Zesta Engineering Ltd. v. Cloutier*,³ the Ontario Superior Court of Justice determined that the wrongful dismissal of fiduciary employees – combining unfounded allegations of just cause, inadequate severance, and a bad faith manner of dismissal – simultaneously terminated all fiduciary duties following the termination, thereby leaving such employees free to compete head-to-head with the former employer without any consequences.

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 for dismissal because, while on Zesta's payroll, the employees were in the process of setting up a new company in direct competition with Zesta, soliciting its clients, and using its confidential information. On the basis that the employees were key fiduciary employees with direct

client responsibilities, Zesta also sought and obtained an interlocutory injunction pending trial preventing the employees from carrying on the competing business or dealing with its clients or information.

The trial judge dealt with the just cause allegation first. The Court determined that the employees' activities in setting up a competing business and in soliciting clients took place after the date of their termination. Also, the Court determined that the employees had remained loyal to their employer – despite the fact that one of the employees had received "secret commissions" from one client which the trial judge determined to be an "isolated occurrence in a long and unblemished career." As a result, there was no improper conduct while they were employed and, therefore, there was no just cause for dismissal. The dismissed employees were held to be entitled to severance. The Court also determined that the manner of termination was unfair and that Zesta's treatment of some of the employees was "shameful," warranting an award of additional and aggravated damages to the terminated employees.

The employees' fiduciary duties were examined next. The Court determined that a wrongful dismissal without just cause and without notice in these circumstances constituted a total repudiation of the employment relationship. Reiterating that fiduciary obligations are imposed by equity – and paralleling recent judicial confirmation of the importance of the right to work and in maintaining an individual's livelihood – 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 termination of employment.

According to the Court, the employer extinguished all express and implied employment terms by its actions, including an employee's fiduciary duties. The Court said: "Considering that [the employees] spent their whole careers ... 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 consequences."⁴ Any employer who is

¹ *General Billposting Co. v. Atkinson*, [1909] A.C. 118 (H.L.).

² *Gerrard v. Century 21 Armour Real Estate Inc.* (1991), 35 C.C.E.L. 128 (Ont. G.D.); see also, *MPA Financial Inc. v. Molinaro*, [1999] O.J. No. 4469 (S.C.J.).

³ (2001), 7 C.C.E.L. (3d) 53 (Ont. S.C.J.).

⁴ *Ibid.* at 315.

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seeking an equitable remedy must "come to the court with clean hands," that is, fully in compliance with its own legal obligations.

Consequently, the Court lifted the injunction so as to permit the dismissed employees to carry on their business freely in competition with Zesta and without restriction. Moreover, the Court went beyond severance and awarded additional damages in order to compensate the employees for having been prevented for several months from conducting business as a result of the initial injunction.

But the case did not end there. Following the issuance of the judgement, a police investigation uncovered evidence indicating that one of the employees had in fact redirected sales of Zesta's products using a third company. The relationship between the employees and the third company had gone unnoticed at the time of the trial, perhaps, as the Ontario Court of Appeal had noted, because it was not owned by any of the employees in question, but rather was owned by the spouse of one of the employee's solicitor. The trial judgment was set aside and a new trial was ordered on the basis of this fresh evidence.

It should be noted, however, that the Court of Appeal did not interfere with the manner in which the trial judge dealt with the fiduciary duties owed by dismissed employees to their former employer. The *Zesta* principle, therefore, still stands and has been subsequently applied by another trial judge, in *Gestion Trans-tek Inc. v. Lampel*.⁵ In that case, the Court stated that 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 that decision, any "precipitous" or abrupt termination of employment without just cause also terminates any of the employee's fiduciary duties.

Summary

There is an important lesson to be learned. Pending further judicial clarification, where an employer dismisses an employee alleging just cause but lacking sufficient evidence to prove it, or where an employer fails to provide reasonable notice or severance, or where an

employer otherwise acts in bad faith, that employer may also be inadvertently putting to an end all fiduciary obligations otherwise owed to it or depriving itself of an effective remedy to stop unfair competition.

Risk on the part of the employer may be minimized by its adoption of some basic steps:

- An employer should be careful before alleging just cause for dismissal, doing so after proper investigation and only where the circumstances are abundantly clear. Otherwise, there is a risk of increased severance and aggravated damages together with enhanced exposure to competition and solicitation by former fiduciary employees.
- Prior to dismissing any fiduciary employee, an employer should assess the potential harm that the employee could bring to the business if he or she competes with the business, solicits customers or other employees, 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, consider gratuitous payments (even without a release!) for a reasonable duration. An employer that pays severance during the period of restricted activity will be better-positioned to seek an injunction or other temporary relief.
- Document the parties' expectations in a fair employment contract, including the employee's restricted activities both during and subsequent to the termination of employment. Such a contract could include reasonable restrictive covenants (non-competition and/or non-solicitation of clients and other personnel) and protection of confidential information. To the extent post-employment restrictions are intended to apply even in the event of a wrongful dismissal, or in the event of a termination without just cause, or in the event of a dispute as to proper severance pay, this expectation should be unambiguously set out in the employment contract.

⁵ [2001] O.J. No. 1206 (S.C.J.).

- Seek professional advice before initiating any termination of employment. A well-communicated dismissal and a fair severance package may pre-empt improper employee conduct. An employee treated fairly throughout a difficult dismissal process will be more inclined to treat the former employer in a similarly fair manner.
- Even in advance of the termination process, treat workers honestly and with

decency throughout the employment relationship. If there is some evidence of a lack of "good faith" or "fair dealing" at any point – but especially during a dismissal – courts will be inclined to intervene in some way in the employee's favour. In such event, the employer is more likely to find itself exposed to increased financial liability and without protection from the actions of a competing former employee.