

# Executive Employment

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## Highlights

### NOTICE OF TERMINATION

## the realities of working notice

Depending on the circumstances, an employer may decide to terminate an employee and provide a period of working notice rather than paying severance in lieu of such notice. In an earlier article in this journal, Janice Payne and Lori O'Neill reviewed the Ontario Court of Appeal decision in *Taylor v. Brown*, which concluded there was no functional difference between working notice and payment in lieu of reasonable notice (see Volume XII, No. 2). In this issue, Eric Durnford and Amy Bradbury address a number of questions which remain from the decision, including, does the nature of the employment relationship change during a period of working notice? What obligations regarding opportunities to obtain alternate employment does the employer owe to the employee? What may be legally expected of the employee with respect to performance and attendance? In addition, if the relationship becomes strained, at what point can the employer terminate for cause and how should reasonable notice then be calculated?

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### DEPARTING EMPLOYEES

## wrongful resignation and unfair competition

Employees also have an obligation to provide their employers with reasonable notice of resignation, and the failure to do so has drawn more attention from the courts. As workforces become increasingly mobile and as businesses become more competitive, failure by employees to provide reasonable notice of resignation is gaining greater attention. Joe Conforti discusses this obligation, and the related restrictions on unfair competition by departing employees, and provides some guidelines to avoid uncertainty at the time of resignation.

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### SEVERANCE

## tax treatment of severance packages

Severance packages, for the most part, are treated as "retiring allowances" under the Income Tax Act, such that special rules apply. Jennifer Fantini reviews the February 1, 2006 Canada Revenue Agency Bulletin on retiring allowances, and discusses the important tax structuring options available to employees on the loss of employment. Whether in respect of unused RRSP deduction room or years of service prior to 1996 with the terminating employer, employees may be eligible for an RRSP "rollover," deferring taxation of the retiring allowance until it is removed from the RRSP, when the employee is in a lower tax bracket.

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## DEPARTING EMPLOYEES

## Wrongful Resignation and Unfair Competition – Guidelines to Avoid Uncertainty at the Time of Resignation

Joe Conforti  
Goodmans LLP

Termination of employment usually focuses on an employer's obligation to provide reasonable notice and severance to dismissed employees. However, employees have a reciprocal obligation to provide reasonable notice to their employers of their intention to resign.

As workforces become more mobile and as businesses become more competitive – all in the context of highly sophisticated, voluminous and readily transferable data – failure by employees to provide reasonable notice of resignation has drawn more attention from the courts.

This issue, termed “wrongful resignation,” involves analysis of various obligations owed by departing employees:

- the period of reasonable resignation required to be given;
- any continuing obligations owed to employers during the period of reasonable notice of resignation; and
- damages and other remedies available to an employer arising from a wrongful resignation.

### Reasonable Notice of Resignation: What Is the Period of Notice?

The law implies into every employment contract the requirement that an employee give reasonable notice of the intended termination of employment to his or her employer.

The purpose of this notice of resignation is to permit the employer sufficient time in advance of the employee's departure to locate replacement workers or otherwise to adapt to the departure.

The required notice of resignation may be fixed by contract<sup>1</sup> or by statute.<sup>2</sup> Alternatively, where there has been no prior agreement and there is no statutory requirement, reasonable notice of resignation takes into account such variables as the responsibilities, compensation and length of service of the employee, as well as the reasonable time it should take the employer to replace the employee.<sup>3</sup>

The employer's right to receive notice of resignation will not necessarily be for the same period of time as the notice/severance that the employer is required to provide to the employee.<sup>4</sup> In general, and based on the reported cases, reasonable notice of resignation from an employee will be substantially less than the period of reasonable notice required for the employer to dismiss the employee.

Each case must be dealt with individually and taking into account the particular employment relationship. In one case involving the wrongful resignation of two senior and key employees, the Court awarded damages for engaging their replacements and training new employees based on a 9-month reasonable notice period.<sup>5</sup> In another case, a project engineer who was not a supervisor and did not hold a key position was found to have discharged his obligations by providing 2-weeks' advance notice of resignation together with 30 hours of services for clients and an additional 5 days training for other employees.<sup>6</sup>

<sup>1</sup> *Ernst & Young v. Stuart* (1997), 27 C.C.E.L. (2d) 289 (B.C.C.A.).

<sup>2</sup> Manitoba imposes a statutory notice of resignation requirement of at least one pay period; see Employment Standards Code, S.M. 1988, section 61.

<sup>3</sup> *Sure-Grip Fasteners Ltd. v. Allgrade Bolt & Chain Inc.* (1993), 45 C.C.E.L. 246 (Ont. Ct. G.D.) at 282.

<sup>4</sup> *Oxman v. Dustbane Enterprises Ltd.* (1986), 13 C.C.E.L. 209 (Ont. H.C.J.), rev'd on other grounds, 23 C.C.E.L. 157 (C.A.).

<sup>5</sup> *Tree Savers International Ltd. v. Savoy* (1992), 39 C.C.E.L. 258 (Alta. C.A.).

<sup>6</sup> *Engineered Sound Systems Ltd. v. Klampfer* (1994), 3 C.C.E.L. (2d) 105 (Ont. Ct. G.D.).

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Nonetheless, it is now generally accepted that – and courts will enforce – a requirement that at least some advance notice of resignation must be provided by employees. This is so even in those workplaces where industry custom is to give little if any notice of resignation. For example, one Court has determined that advisors in investment/financial brokerages ought to have given 2 1/2 weeks' notice even though industry practice in the past had been to give no advance notice of departure.<sup>7</sup>

An employer's response to a notice of resignation is key. An employer may, expressly or through its conduct in accepting the resignation, terminate employment immediately and thereby waive its right to reasonable notice of resignation.<sup>8</sup> This may have the unintended effect of discharging the employee from liability for wrongful resignation and, potentially, other ongoing obligations to the employer.

### Continuing Obligations During Period of Notice of Resignation

All employees owe a duty of "good faith and fidelity" to their employers. In particular, at all times during employment, an employee must not act out of self-interest, but rather, must act with a view to protecting or promoting the employer's business interests.

As a result, an employee cannot, during employment or prior to departing from employment, compete against the employer, nor can the employee solicit its customers or personnel, nor can the employee make definitive plans to do so.<sup>9</sup> Further, an employee cannot put himself in a position where his own interests would detract from his ability to work fully and completely for the benefit of the employer. This duty of good faith and fidelity requires that an employee be "open, honest and forthright" with the employer and to "make full disclosure of all material facts that, as an employer, it would be entitled to

know to successfully operate its business."<sup>10</sup> Such mandatory disclosure could include, for example, the employee's intent to compete with the employer and that the employee has taken steps in this regard.

It is important to recognize that employment continues unbroken throughout the period of notice of resignation. Consequently, all obligations, including the employee's duty of good faith and fidelity to the employer, also continue during this time. Where the employee ought to have provided notice of resignation but fails to do so or where the employee fails to provide sufficient notice of termination, the duty of good faith and fidelity will continue for the entire reasonable notice period; accordingly, the duty extends even beyond the employee's last day of active employment. Participation by the resigning employees in competitive activities during this period of reasonable notice of resignation constitutes a breach of contract and a breach of the duty of good faith and fidelity.<sup>11</sup>

The recent *RBC Dominion Securities v. Merrill Lynch Canada* decisions of the British Columbia Supreme Court have expanded this employee duty of good faith and fidelity so as to encompass a general prohibition on "unfair competition" with the former employer.<sup>12</sup> In these decisions, damages were awarded to a former employer when several departing employees failed to give reasonable notice of their intended resignation and when, instead, they went directly and immediately to a competitor, causing the near collapse of the business of the former employer.

Although its analysis involved breaches by the departing employee, the Court in *RBC Dominion Securities v. Merrill Lynch Canada* made several significant determinations regarding the duty of resigning employees:

- Where appropriate notice has not been given by the departing employee, it would not constitute "fair competition" for a departing employee to compete against the

<sup>7</sup> See *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.*, [2003] B.C.J. No. 2700 (B.C.S.C.) ("*RBC Dominion Securities #1*") and *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc.*, [2004] B.C.J. No. 2337 (B.C.S.C.) ("*RBC Dominion Securities #2*").

<sup>8</sup> *Engineered Sound Systems Ltd.*, supra note 6.

<sup>9</sup> See, e.g., S.R. Ball, *Canadian Employment Law* (1996), at 15-1ff.

<sup>10</sup> *Felker v. Cunningham* (2001), 191 D.L.R. (4th) 734 (Ont. C.A.).

<sup>11</sup> *Restauronics Services Ltd. v. Forster* (2004), 32 C.C.E.L. (3d) 50 (B.C.C.A.), at 63; see, also, Ball, supra note 9 at 15-1ff.

<sup>12</sup> *RBC Dominion Securities #1 and RBC Dominion Securities #2*, supra note 7.

former employer for its own clients, since the departing employee is acting from a position that the former employer could not possibly match – indeed, where the former employer often is not even aware of the potential loss of clients.<sup>13</sup>

- A departing employee has an obligation to refrain from soliciting the former employer's clients until the former employer has had a reasonable opportunity to contact the clients to reassure them that it is keen and able to continue to service their needs with qualified and capable staff.<sup>14</sup>
- The duration that a departing employee is to be restricted in his post-employment competitive activities should be equivalent to the notice of resignation that was or that ought to have been provided to the former employer; this period will vary with the circumstances, but is designed to permit the former employer with a reasonable time to find a replacement or to otherwise adapt to the loss.<sup>15</sup>
- The duration that the departing employee can be prohibited from competing unfairly with the former employer may be extended beyond the period of notice of resignation that ought to have been provided where there is a coordinated resignation of numerous employees as a group which has the intent or effect of leading to the collapse of the former employer's business.<sup>16</sup>
- Damages (including substantial punitive damages arising out of a departing employee's breaches of duty) will be awarded not only against the departing employee, but also against the new employer if it induced and/or benefited from the improper activities.<sup>17</sup>

<sup>13</sup> *RBC Dominion Securities #2*, *ibid.* at paragraphs 59 and 72.

<sup>14</sup> *RBC Dominion Securities #1*, *ibid.* at paragraph 117.

<sup>15</sup> *RBC Dominion Securities #2*, *ibid.* at paragraph 70; *RBC Dominion Securities #1*, *ibid.* at paragraphs 70, 117.

<sup>16</sup> *RBC Dominion Securities #1*, *ibid.* at paragraph 117.

<sup>17</sup> *RBC Dominion Securities #1*, *ibid.* at paragraph 136; *RBC Dominion Securities #2*, *ibid.* at paragraphs 143, 148 and 156.

The bottom line: courts will not tolerate unfairness in competition, especially if the activities of departing employees are conducted secretly and with the effect of leaving the former employer unable to function at all.

Transfers of employment must be effected fairly, with proper and fulsome advance notice to the employer; failure to provide proper notice of resignation may lead to enhanced restrictions of post-employment conduct based on "unfair competition" principles.

### Damages and Other Remedies

Failure on the part of departing employees to provide reasonable notice of resignation gives the employer a right to claim and to receive damages.

Damages must be based on actual harm caused to the former employer which, in most instances, will be based on what the former employer has lost (lost profits and/or capitalized value of future loss of profits, decrease in the value of its business, lost contracts, the direct costs of replacing the departing employees and the training of new employees during the notice of resignation period, etc.), or alternatively, may be based on an accounting of and disgorgement of all profits made by the departing employees as a result of the breach of their obligations.

Where the former employer alleges a breach, it must prove the amount of losses suffered. In assessing damages at trial, courts will consider the following factors:

- the level and duration of the obligations owed by the departing employee;
- the seriousness and particulars of the departing employees' proven misconduct;
- the reliability of the financial evidence;
- the malicious intent or other bad faith by the departing employee; and
- any mitigation and other efforts by the employer to minimize the harm.<sup>18</sup>

<sup>18</sup> *McCormick Delisle & Thompson Inc. v. Ballantyne* (2000), 9 C.C.E.L. (3d) 50 (Ont. C.A.); *Sanford Evans List Brokerage v. Trauzzi* (2000), 50 C.C.E.L. (2d) 105 (Ont. S.C.J.).

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The *RBC Dominion Securities v. Merrill Lynch Canada* decisions represent a recent highwater mark for damages and forewarns that substantial damages – even into the millions of dollars – may be awarded in favour of wronged employers. That case awarded the plaintiff's former employer for all lost profits occasioned to it over a five-year period following the cessation of employment (on the theory that the departing employees' mass departure, lack of advance notice of resignation, client solicitation and misuse of confidential information caused the near collapse of the employer branch's business).

In addition, the Court awarded all lost profits of the former employer incurred during the period of notice that the departing employees should have provided of their resignation (the notice was fixed at 2 1/2 weeks). Finally, in order to express disapproval at the "planned, prolonged and secret scheme to arrange a wholesale transfer of information to a competitor," the Court ordered punitive damages against the departing employees (fixed at between \$5,000 to \$10,000 each) and \$250,000 against the new employer for inducing breach of contract and otherwise participating in the employees' wrongdoing.

### Conclusion

The imposition on departing employees of notice of resignation and ancillary obligations effectively restricts employees' post-employment activities and provides substantial protection to employers from unfair competition during this period. As a result, there is an increasing overlap between wrongful resignation and breach of fiduciary duties/unfair competition litigation.

Mis-steps may result in serious legal consequences.

Consideration of some guidelines will avoid uncertainty at the time of termination of the employment relationship:

- The parties' expectations should be documented prior to the commencement of employment in a fair employment contract, including the employee's restricted activities both during and subsequent to any termination of employment. Such a

contract could include reasonable notice of termination obligations (both to and from the employer), as well as reasonable and necessary restrictive covenants tailored to the particular business (non-competition and/or non-solicitation of clients or personnel and/or protection of confidential information).

- A departing employee should provide reasonable advance notice of resignation to the employer, providing sufficient time to allow the employer to find a replacement or to make transition arrangements. To the extent possible, a departing employee should not resign in concert with other employees as the legal and practical risks increase.
- A departing employee should seek professional advice in order to determine any restrictions on post-employment conduct.
- The employer should consider whether it wishes to strictly enforce contractual notice of resignation requirements or to accept advance notice of resignation provided by a departing employee. During this notice of resignation period, the employees' duty of "good faith and fidelity" continues – effectively, a non-competition covenant, whereas immediate acceptance of the resignation and termination of employment may nullify this benefit.
- A departing employee should recognize that, during any notice period, good faith and fidelity obligations to the employer continue. There can be no copying, removal, or use of the employer's confidential or proprietary information other than for the purposes of the employer. Any confidential information or property should be returned immediately. No competition or solicitation can occur during the notice period of termination. Assistance should be provided by the departing employee to the employer as required during the notice/transition period.
- A departing employee should be mindful that e-mails and other computer systems remain the property of the employer and fully accessible in the event of any dispute.

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Accordingly, care should be exercised in the nature and content of all communications.

- A prospective new employer must make due inquiry of prospective employees in order to ensure that it is aware of

non-compliance with post-employment restrictions.

- A departing employee should consider whether an indemnification is available or appropriate from the prospective new employer.