

# MANAGEMENT COUNSEL

Employment and Labour Law Update

SPECIAL EDITION



The Supreme Court's decision will alter the way in which employees, employers and courts approach and consider *Wallace* and punitive damages in wrongful dismissal lawsuits.

## *Honda v. Keays* – Back to the Starting Line!

Employers can breathe a little easier. The Supreme Court of Canada has struck down the highest ever punitive damage award given in a wrongful dismissal law suit.

In a much anticipated decision, released June 27, 2008, the Supreme Court set aside, in part, a ground-breaking award against Honda Canada Inc. (“Honda”). The trial judge had awarded \$500,000 punitive damages against Honda for, in the judge’s words, egregious behaviour, a “corporate conspiracy” and a “litany of acts of discrimination and harassment” in relation to a dismissed employee. That amount was reduced to \$100,000 by the Ontario Court of Appeal which found no evidence of a corporate conspiracy warranting such an extraordinary award. The Supreme Court of Canada went even further, reducing the award to zero.

The Supreme Court’s decision will alter the way in which employees, employers and courts approach and consider *Wallace* and punitive damages in wrongful dismissal lawsuits.

No longer will *Wallace* damages, should they apply to a particular set of facts, be awarded by way of an arbitrary extension of the notice period. The Supreme Court has made it very clear that *Wallace* damages are to be quantified as a fixed amount, in accordance with the same principles and in the same way as other types of compensatory damages.

The Court also warned lower courts not to confuse *Wallace* damages with punitive damages, and not to allow *Wallace* damages to be used as a way of indirectly ordering punitive damages against employers. Punitive damages, said the Court, are intended to punish the employer for actions that are so malicious and outrageous that they are deserving of punishment on their own. They should only be awarded where the employer’s conduct is harsh, vindictive, reprehensible and malicious. In other words, punitive damages, while still possible within the context of a wrongful dismissal, should be rare.

### Background Facts

In 1997, Keays was diagnosed with Chronic Fatigue Syndrome. As a result, he stopped work and began receiving disability benefits through an independent insurance provider, London Life Insurance Co. (“London Life”). In 1998, London Life discontinued Keays’ benefits based on the insurer’s evaluation that he could return to work full-time. Keays’ appeal to the insurer was denied. Honda had no part in the decision to terminate Keays’ benefits.

Although the basis of London Life’s decision was a medical opinion that Keays could return to work without restriction, Keays

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continued to absent himself. He was placed in the Honda Disability Program which permitted disabled employees to take absences without invocation of Honda's attendance policy by confirming that the absence from work was related to a disability. Keays, however, missed more work than his diagnosing physician had predicted, and the notes offered to explain his continued absences changed in tone. This left Honda to believe that the doctor had not independently evaluated whether Keays was absent due to disability.

In these circumstances, Honda asked Keays to meet with an occupational medical specialist in order to determine how his disability could be accommodated. Initially Keays agreed. However, upon retaining a lawyer, Keays changed his mind and refused to meet with the medical specialist without an explanation of the purpose, methodology and parameters of the consultation.

Shortly thereafter, Honda gave Keays a letter stating that it supported his full return to work but that his employment would be terminated if he refused to meet with the medical specialist. When Keays refused, Honda terminated his employment for insubordination. Keays sued for wrongful dismissal.

### The Trial Decision

The trial judge found that Keays was entitled to a notice period of 15 months, as well as additional damages arising out of the *manner* of dismissal (*Wallace* damages), for a further nine months' notice (a total of 24 months notice). Punitive damages were also assessed against Honda in the amount of \$500,000, as well as a substantial portion of the legal costs.

Specifically, the trial judge decided that:

- Keays had been wrongfully dismissed. The requirement that he see Honda's specialist doctor was unreasonable and Keays had a reasonable excuse for not complying with the order. In all of the circumstances, termination was not a proportionate employer response.
- Keays was entitled to 15 months' reasonable notice. Keays was one of the first employees hired at Honda's plant and had spent his entire adult life with Honda. He had little formal education. He was the "guru" of the department and the "go-to" guy. These factors all pointed to a lengthy period of notice.
- Honda displayed bad faith in the manner of Keays' termination. Honda deliberately misrepresented the views of its doctors; was attempting to "set up" Keays by asking him to see Honda's own specialist; and Honda's decision to cancel Keays' accommodation (in the form of permitting his ongoing absence without disciplinary consequences) following his refusal to see Honda's doctor was a form of "reprisal" for Keays retaining a lawyer. Keays' condition also worsened after his dismissal. As such, this was a case for *Wallace* damages in the amount of an additional nine months' notice.
- Punitive damages should be awarded against Honda because of a "corporate conspiracy" against Keays, a "litany of acts of discrimination and harassment in relation to [Keays] attempts to resolve his accommodation difficulties", and a "conspiracy" on the part of Honda to preclude Keays' own doctor from participating in the accommodation process.

### The Court of Appeal

The Ontario Court of Appeal unanimously upheld the finding of wrongful termination, the 15 months' notice, and the nine month *Wallace* extension. However, the majority of the Court ordered that the quantum of punitive damages be reduced. According to the Court, although there was evidence suggesting planned and deliberate attempts by Honda to intimidate and then dismiss a vulnerable employee, there was no evidence of a corporate conspiracy warranting such an extraordinary award. The trial judge's award was simply disproportionate to the evidence presented at trial. The Court of Appeal therefore reduced the punitive damages from \$500,000 to \$100,000. Costs were also significantly reduced.

### The Supreme Court of Canada

Both parties appealed to the Supreme Court of Canada. Honda conceded that Keays had been wrongfully dismissed, but maintained that the award of 15 months' notice was too high. Honda also challenged the award of *Wallace* damages, punitive damages and costs. Keays argued the opposite.

The Court addressed the following key issues:

- A. The factors to be considered when determining an appropriate period of reasonable notice.
- B. The nature and scope of *Wallace* damages and punitive damages.

#### A. The factors to be considered when determining an appropriate period of reasonable notice.

Relying on the leading case of *Bardal v. Globe and Mail*, the Supreme Court restated the four key factors to be considered when assessing the period of notice which must be provided to an employee upon termination, referred to as the common law notice period. These factors are: (i) character of employment; (ii) length of service; (iii) age of dismissed employee; and (iv) availability of similar employment having regard to experience, training and qualifications.

Applying these factors, the Supreme Court agreed with the conclusions of the trial judge and found no basis to interfere with the 15 month notice award. All of the *Bardal* factors, taken together with equal weight, supported this finding. Honda had argued that its "flat management structure" meant that Keays could not be said to have been managerial. Accordingly, he should not be entitled to 15 months notice. However, the Court found that this was not a material or even a significant factor. Keays' title or position said nothing of Keays' actual employment, functions or skills. The Supreme Court also highlighted Keays' lack of formal education and the fact that he suffered from an illness which greatly incapacitated him. All of these factors substantially reduced his chances of re-employment and justified the assessment of 15 months' notice.

#### B. The nature and scope of *Wallace* damages and punitive damages.

The Supreme Court's discussion of *Wallace* damages and punitive can be summarized as follows:

- An action for wrongful dismissal is based on a breach of an implied obligation to give reasonable notice of the intention to terminate the employment relationship in the absence of just cause.

- The general rule is that damages in a wrongful dismissal action are confined to the loss suffered as a result of the employer's *failure to give proper notice*. No damages are available to the employee for *the actual loss of his or her job* and/or for the pain and distress that may have been suffered *as a consequence of being terminated*.
- This is consistent with a general principle of contract law - that damages are only awarded for a breach of contract if they are within the "reasonable expectation" of the parties as flowing from the breach. That is, damages must either fairly and reasonably be considered to *arise naturally from the breach itself, or otherwise have been within the contemplation of both parties at the time the contract was made*.
- Within the context of a wrongful dismissal action, the first question to ask is "*what did the contract promise?*" In other words, what was contemplated by the employer and the employee when they formed their contract? Prior to the Supreme Court's decision in *Wallace*, the answer was this: *a job for the employee, on the understanding that the employer would give reasonable notice of an intention to terminate the relationship in the absence of just cause*.
- In *Wallace*, however, the Supreme Court created a further obligation for the employer; "an obligation of good faith and fair dealing in the manner of dismissal". In so doing, the Court created the expectation that, in the course of dismissing an employee, employers will be "candid, reasonable, honest and forthright with their employees". Failure to fulfill this obligation constitutes a separate breach of the employment contract which can lead to damages known as "*Wallace*" damages.
- **Wallace damages are to be determined according to the same principles and in the same way as other cases dealing with damages that are intended to compensate the aggrieved party for actual loss. Wallace damages are not to be awarded by way of an extension of the period of reasonable notice. The period of reasonable notice is a separate issue and is to be determined by applying the principles in *Bardal*.** In the words of the Supreme Court:

*[I]n cases where damages are awarded, no extension of the notice period is to be used to determine the proper amount to be paid. The amount is to be fixed according to the same principles and in the same way as in all other cases dealing with moral damages. Thus, if the employee can prove that the manner of dismissal caused mental distress that was in the contemplation of the parties, those damages will be awarded not through an arbitrary extension of the notice period, but through an award that reflects the actual damages. Examples of conduct in dismissal resulting in compensable damages are attacking the employee's reputation by declarations made at the time of dismissal, misrepresentation regarding the reason for the reasons for the decision, or dismissal meant to deprive the employee of a pension benefit or other right, permanent status for instance (para. 59) [emphasis added].*

- Punitive damages are separate and distinct from *Wallace* damages. Damages for conduct in the manner of dismissal – *Wallace* damages - are *compensatory*; they are intended to compensate the employee for actual loss. Punitive damages are intended to *punish* the employer for actions that are so

malicious and outrageous they are deserving of punishment on their own. Courts should only resort to punitive damages in exceptional cases. Conduct meriting punitive damages awards must be harsh, vindictive, reprehensible and malicious as well as extreme in nature and by any reasonable standard deserving of full condemnation and punishment.

Having clarified the state of the law, the Supreme Court turned its attention to the facts in *Honda v. Keays*.

## Is Keays Entitled To *Wallace* Damages?

On the evidence before it, the Supreme Court found that Honda's conduct in dismissing Keays was neither egregious nor a display of bad faith behaviour that justified an award of *Wallace* damages. In reaching this conclusion the Court found that the trial judge had made a number of "*palpable and overriding errors ... which coloured the trial judge's judgment, making other findings and inferences suspect*".

Specifically the Supreme Court made the following findings:

- There was no evidence to support the conclusion that Honda's alleged misconduct was "planned and deliberate and formed a protracted corporate conspiracy."
- The trial judge was in error when insisting that the "outrageous conduct" had continued for five years, when in fact the problem period was no more than seven months. The trial judge therefore was considering the wrong period. This error appears to have lead the judge to conclude, in part, that Honda was responsible for the decision by London Life to cancel Keays' disability insurance.
- Honda had not misrepresented the position of the doctors, but rather had merely relied on the advice it had received from medical experts that Keays was fit to return to work.
- Honda had not attempted to "set up" Keays by asking him to see Honda's own medical specialist. This request was normal in the circumstances.
- Honda's decision to cancel its accommodation and stop accepting doctor's notes was not a form of reprisal for Keays' decision to retain legal counsel. Honda was not unreasonable in taking the position that Keays' doctor's notes had become "cryptic" and were deficient. Honda was simply seeking to confirm the continued existence of Keays' disability.
- There was no evidence of a conspiracy to terminate Keays' employment. The Supreme Court agreed with the Court of Appeal that "[Honda] accommodated [Keays] increasingly more serious disability over several years. The fact that the company ran a lean operation in which it was difficult to accommodate prolonged absences was not proof of a conspiracy."
- There was no evidence that Keays' disability subsequent to his termination was caused by the manner of termination.

## Did Honda's actions warrant "punitive" damages?

On each of the grounds advanced by Keays the Supreme Court answered this question "no". Honda's actions were not so outrageous as to warrant punishment in the nature of punitive damages. In reaching this conclusion the Court reduced to zero what was once a \$500,000 punitive damage award against Honda. Significantly, the Court found that:

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- Honda was not responsible for the decision by London Life to cut off Keays' long-term disability benefits.
- Honda did not know, nor could it have known based on the evidence before it, of the seriousness or true nature of Keays' medical condition. His file did not disclose this information and Keays refused to meet with Honda's medical expert. Honda was sceptical about Keays' disability and was taking steps to confirm it but Keays would not facilitate an exchange of information about his condition.
- Honda's refusal to deal with Keays' lawyer was not outrageous behaviour. There is no legal obligation on the part of an employer to deal with an employee's counsel while he or she continues with his or her employment. Parties (as opposed to lawyers) are always entitled to deal with each other directly.
- Telling Keays that hiring a lawyer was a mistake which would make things worse was "ill-advised and unnecessarily harsh, but it [did] not provide justification for an award of punitive damages."

**Lessons Learned**

As indicated at the outset, the Supreme Court's decision may significantly change the way in which employees, employers, and the courts will approach the issue of *Wallace* and punitive damages.

No longer will *Wallace* damages be awarded by way of an arbitrary extension of the notice period. Instead, the Supreme Court made it very clear that *Wallace* damages are to be quantified as a fixed amount, in accordance with the same principles and in the same way as other cases dealing with compensatory damages.

This may benefit employers in two key ways: First, until now, a plaintiff could simply claim *Wallace* damages and allow the court to arbitrarily award an additional period of notice. Now a plaintiff must specifically quantify his/her loss resulting from a breach of the duty of good faith dismissal. This may be difficult to do. Second, the requirement that the loss be specifically quantified will allow employers to know ahead of time (i.e. through pleadings, the process of discovery or pre-trial discussions) the quantum of *Wallace* damages at issue. Both of these factors may lead to fewer *Wallace* claims, and a more predictable and rational basis for those claims that are successful.

The Supreme Court's discussion of punitive damages is also very helpful. By restating the legal principle that punitive damages are to be reserved for only the most malicious and outrageous of behaviour, the Court made it clear that punitive damages should be awarded only in the rarest and most obvious of cases.

Beyond its discussion of *Wallace* damages and punitive damages, the Supreme Court's decision is significant for employers in that it reinforces the following principles of employment law:

- The general rule is that damages in a wrongful dismissal action are confined to the loss suffered as a result of the employer's failure to give proper notice. No damages are available to the employee for the actual loss of his or her job and/or for pain and distress that may have been suffered as a consequence of being terminated.
- The four key factors in *Bardal* continue to be the framework with respect to an assessment of reasonable notice - no one single factor is more important than the others.

Finally, the Supreme Court's findings are of *operational* significance to employers. Namely:

- The fact that an employer runs a lean operation in which it may be difficult to accommodate prolonged absences is not proof of a conspiracy.
- The object of a disability program is to maintain regular contact with the employee and/or his/her doctor in order to support treatment. The need to monitor absences of employees who are regularly absent from work is a *bona fide* work requirement in light of the very nature of the employment contract and responsibility of the employer for the management of its workforce.
- An employer's refusal to deal with an employee's lawyer does not constitute outrageous behaviour. There is no legal obligation on the part of an employer to deal with an employee's counsel while he or she continues with his or her employment.
- The employer cannot accommodate that of which it is unaware. An employee has a duty to facilitate the exchange of information that is required for the process.

*To learn more about this important decision, and how it may affect your workplace, please contact a member of the Sherrard Kuzz LLP team.*



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