

# How to Avoid Wallace Damages for Bad Faith Termination



Do you know where to draw the lines between good and bad faith?

Termination is difficult for all involved. It also comes at a financial price when termination is without cause because you have to pay out termination notice, vacation and other employment standards and perhaps other severance amounts due under the contract. It can get really expensive when termination isn't merely wrongful but mean and nasty. Employees who are terminated in bad faith and suffer mental distress as a result are entitled to exemplary damages known as *Wallace* damages.

## **The Law of *Wallace* Damages**

The name "*Wallace* damages" comes from the very first case to award them, a 1997 Canadian Supreme Court ruling called [\*Wallace v. United Grain Growers\*](#), 1997 CanLII 332 (SCC), [1997] 3 SCR 701. It all began when a Manitoba grain company fired a 45-year-old salesman after 14 years of service. The salesman's record was stellar. He had been named the company's top salesperson every year he was there. When it first hired him, the company had also verbally assured him of job security and fair treatment. But the company wasn't true to its word. When the axe fell, it refused even to explain its reasons—other than to say it had good cause for its decision.

The salesman sued and the case eventually landed in the Supreme Court. The Court sided with the salesman. Every employer has an implied obligation of good faith and fair dealing to its employees, the Court reasoned. Termination doesn't extinguish this obligation. On the contrary, good faith is especially important at termination since this is when employees are at their most vulnerable. According to the Court, employers who show bad faith during termination, that is, who cause "humiliation, embarrassment and damage to [an employee's] self-esteem," should pay damages.

The grain company displayed such bad faith and thus owed the salesman compensation. How much? The Court decided that courts should consider bad faith as a factor in deciding how many months of notice—or salary in lieu of such notice—that a terminated employee is entitled to receive. In this case, the Court ordered the grain company to pay a whopping 24 months' notice, or \$15,000 in damages.

But *Wallace* damages started getting out of hand and the Supreme Court decided it had to pump the brakes. In a 2009 case called [\*Honda Canada Inc. v. Keays\*](#), 2008 SCC 39 (CanLII), [2008] 2 SCR 362, the Court drew some new lines. Termination in bad faith would no longer be enough to hand out *Wallace* damages. From now on, employees would also have to prove that they suffered mental distress or other actual losses as a result of the bad faith way in which they were terminated. *Wallace* damages would then compensate employees for those losses.

## Drawing the Lines between Good & Bad Faith

*Wallace* damages are based not so much on the termination decision as how it's made and carried out. **Rule of thumb:** Always treat the employees you fire with dignity, courtesy and respect. After all, if you act in good faith, you won't have to worry about *Wallace* damages. It all sounds so easy. In the real world, the line between good and bad faith isn't always so easy to discern.

## What's Wrong with This Termination?

To test your understanding of what you should and shouldn't do to minimize liability risk when firing an employee, we've created a hypothetical termination scenario involving an employer who's about to commit 7 mistakes that could later result in *Wallace* damages. How many of the 7 mistakes can you spot?

### Scenario

An employer invites a group of employees to work for him as part of a team. The team is given various projects to complete and evaluated on how well it performed each week. The exercise is part of a contest. Although they work together, the individuals on the team are competing for one high-profile position in the company. Only one team member can win—and those that don't win get fired.

Each week, all the team members are brought into a boardroom before the employer and 2 of his advisors, where they're grilled about the team's performance. Everyone knows that at the end of the meeting, someone on the team is going to be fired. Employees are excused from the boardroom while the employer and his advisors decide which one must go. The employees then return. The employer recites a litany of everything the team did wrong. The meeting culminates with the employer's placing the blame for the team's performance on one employee's shoulders and then firing him. The fired employee is immediately escorted out of the boardroom—and the building—in front of his teammates.

Does the scenario sound familiar? If you watch TV, it should. After all, it's modeled on the old reality TV show, *The Apprentice*, starring Donald Trump. At the end of each show, Trump would terminate a contestant with the dramatic phrase "You're fired."

## The 7 Mistakes

If Donald Trump were Canadian and this was the way he ran his business, he'd have been in a heap of legal trouble.

### 1. The Termination Was Public

Firing an employee isn't a spectator sport. It should be done in private—and not in front of the employee's colleagues or peers. Here, the employee was fired in front of

his co-workers. Although this behaviour may make for entertaining TV, in the real employment world it's unnecessarily humiliating, legally inappropriate and grounds for *Wallace* damages.

**Example:** A pawn broker in Ontario eliminated an employee's job as part of the company's restructuring. The employee was brought into the management office, where she was fired. She was escorted to the counter where she'd worked to get her personal belongings and then paraded out of the store in front of coworkers and customers. A court awarded the employee *Wallace* damages, ruling that the termination was humiliating and compared it to a "perp walk" [*Therrien v. Hock Shop Canada*, [2005] O.J. No. 3303].

The only people who should be present when an employee is fired are the employer and one other senior manager as a witness. The employee in the hypothetical was fired in front of not only his co-workers, but also the employer and 2 senior advisors. And firing an employee before a group of supervisors or senior management creates a firing-squad-like atmosphere, and is inappropriate.

## **2. The Termination Wasn't Secret**

The fact an employee is going to be fired should be kept secret and not become common knowledge. Only those who are involved in the decision to fire an employee or participate in the termination should know. In our hypothetical, everyone on the team knows a head is going to roll; they just don't know whose it will be.

## **3. The Team Member Didn't Get a Warning or Chance to Remedy the Problem**

A number of *Wallace* damages cases have found an employer's failure to warn the employee before firing to constitute bad faith. Firing an employee out of the blue and without giving them a chance to correct the problem is likely to be seen as unfair. In our scenario, the fired employee never gets a warning. Although the boss tells him all the things he did wrong, he never gives the employee an opportunity to improve his behaviour or job performance.

## **4. The Employer Falsely Implied that Termination Was for Cause**

In the scenario, the employer implies that the employee is being fired for cause by listing all the things he did wrong. But in fact, the reasons he lists are unlikely to constitute just cause for termination. What's more, the employer probably knows that. After all, somebody is automatically going to get fired each week. The point is that it's wrong to say or imply that an employee is being fired because of conduct or poor performance when that's not actually true. **Bottom line:** If you don't have cause for firing an employee, don't pretend that you do.

## **5. The Employee Was Terminated Without Notice or Compensation**

The employee in the scenario wasn't really fired for cause. Nonetheless, he was treated like somebody who was fired for cause and not provided the termination notice to which he was entitled under ESA laws.

## **6. The Employer Didn't Help the Fired Employee Get a New Job**

If possible, help fired employees find a new job, especially if termination is without cause. In addition to being morally questionable, bad mouthing a former employee, unreasonably withholding a letter of reference or otherwise deliberately making it harder for them to land a new job puts you at risk of *Wallace* damages.

## **7. The Termination Was Done in a Humiliating & Degrading Manner**

Maybe the biggest mistake the employer in our scenario made was to fire the employee in a humiliating and degrading manner. The employee was fired in front of both colleagues and supervisors after having his performance compared to his teammates' and torn apart. He was then escorted out of the room and the building. The employer showed no sensitivity and made no effort to cushion the blow. Employers must understand that being fired is one of the most difficult things that can happen to a person and show sensitivity when delivering the bad news.