Wallace/Moral Damages & Bad Faith Termination Prevention Game Plan

The toughest part of managing employment relationships is putting them to an end. In addition to the emotional toll, terminating an employee is expensive when it's without cause because the company has to pay termination notice, vacation, and other amounts required by employment standards laws and the contract being terminated. There's also the legal risk that a court or arbitrator will find the termination wrongful and award the employee damages. And it gets 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 a special kind of exemplary damages known as *Wallace* damages, aka moral damages. Here's a briefing on the legal risk and an 8-step compliance game plan to help you manage it.

The Law of *Wallace* Damages

The name "*Wallace* damages" comes from a 1997 Canadian Supreme Court ruling called *Wallace v. United Grain Growers*, 1997 CanLII 332 (SCC), [1997] 3 SCR 701. The case began when a Manitoba grain company fired a 45-year-old salesman after 14 years of stellar service during which he was named the company's top salesperson every single year. 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 where he scored a total victory. 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 the time of 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 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.

For about 2 decades, courts began tacking on extra months of termination notice known as "*Wallace* bumps" almost as a matter of routine. Feeling that the situation was getting out of hand, the Supreme Court imposed some new restrictions in a 2009 case called *Honda Canada Inc. v. Keays*, 2008 SCC 39 (CanLII), [2008] 2 SCR 362. Showing bad faith during termination would no longer be enough to justify *Wallace* damages. From now on, employees would also have to prove that they suffered mental distress as a result of the bad faith way in which they were terminated.

Moreover, the Court clarified that mental distress goes beyond hurt feelings. Employees would now have to provide demonstrable evidence that the employer's actions caused severe and extended disruption beyond the normal upset feelings or difficulties finding jobs that employees typically experience when they get fired. *Wallace* damages would then compensate employees for those losses and not simply be a termination notice bump.

Determining the Line between Good & Bad Faith Termination

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 may sound easy but in the real world, the line between good and bad faith isn't always so easy to discern. Unfortunately, there are no specific statutory or regulatory guidelines defining bad faith. But what we do have is case law showing how courts apply the general rules of Wallace damages to actual termination situations. Based on these cases, we can outline 8 patterns or practices that companies should be sensitive to and careful to avoid when carrying out the termination process.

Step 1. Be Sensitive in Providing the Reasons for Termination

Much of the bad faith conduct that gives rise to claims for *Wallace* damages happens during the meeting in which the company notifies the employee of termination. One pitfall to avoid is being evasive or refusing to provide a reason for termination. The company in the original *Wallace* case learned this lesson the hard way when it stonewalled the grain salesman when he asked why he was fired. By the same token, there's a fine line between honest and harsh.

Example: "It doesn't matter," replied the minerals company during the termination meeting when the engineer asked why he was being fired. But when the engineer pressed for an answer, management let him have it, stating that he wasn't a good manager or engineer and that he was embarrassing the company. The BC court found this to be an unduly harsh attack on the engineer's competence and awarded him $12,500 in *Wallace* damages [*Younesi v Kaz Minerals Projects B.V.*, 2021 BCSC 614 (CanLII)].

Takeaway: A big part of acting in good faith is simply to be sensitive to the employee's situation and not act like a jerk. This is especially true during the termination meeting itself. While you should be prepared to provide your reasons for termination, particularly if the employee asks for them and/or termination is for cause, deliver the information in a professional and non-insulting or accusatory fashion.

Step 2. Don’t Lull Employees Slated for Termination into a False Sense of Security

Good faith, says the Court in *Wallace*, involves being “candid, honest, and forthright” with employees at the time of termination. However, in applying the standard, courts consider the entire context of the employment relationship, including the months and weeks leading to the termination decision. When news of termination comes as a total bolt from the blue, the risks of bad faith and mental distress increase. This is especially true when a company lulls the employee into a false sense of security or deliberately conceals information suggesting that their position is in peril.

Example: Red Lake, a mine company that has just been acquired, assures its general manager that the acquiring firm will offer him employment. What it doesn’t tell him is that he won’t be allowed to keep working at Red Lake if such an offer is not forthcoming. Four months later, the acquiring company decides not to hire the general manager and Red Lake terminates him without cause. The Ontario court finds that Red Lake engaged in untruthful, misleading, and unduly insensitive conduct and awards the general manager $50,000 in *Wallace* damages [*Gascon v. Newmont Goldcorp,* 2022 ONSC 2511 (CanLII)].

Takeaway: One of the worst things you can do to the employees you terminate is blindside them. While you don’t want to foment panic or unnecessary stress, employees at risk of losing their job should know of their status so they have some inkling of what’s coming. Of course, there may be situations where it’s not reasonable or advisable to deliver such a warning. But what you never want to do is falsely reassure employees that their job is safe.

Step 3. Don’t Renege on Assurances of Job Security

Another factor in determining bad faith at the time of termination are the promises or representations about job security, salary, benefits, or other material terms of employment that a company makes to recruit the employee. Making and then reneging on these assurances may constitute bad faith justifying *Wallace* damages, especially if termination occurs early during the employee’s tenure.

Example: A telecommunications consultant is considering 2 job offers. But one of the companies promises to offer her an equity position and a coveted international role. On that basis, she accepts the job. The employer doesn’t deliver. A year later, it fires the consultant. The Ontario court awards the consultant *Wallace* damages [*Marshall v. Watson Wyatt & Co.*, 2002 CarswellOnt 962, 112 A.C.W.S. (3d) 834].

Takeaway: Be mindful of the promises or representations you made to the employees you intend to terminate. To avoid the risk of bad faith, it may be necessary to address and perhaps even reach a settlement resolving these issues as part of the severance negotiations and release agreement.

Step 4. Terminate Employees in Private, Not in Front of Co-Workers

Termination is an intensely sensitive and private affair—at least it should be. That’s why the original *Wallace* decision describes the duty of good faith as requiring employers to refrain from terminating in a way that “humiliates, embarrasses”, or degrades the employee’s self-esteem.

Example: A bartender accused of theft is fired during his shift and unceremoniously escorted from the premises in front of patrons and co-workers. The Nova Scotia court orders the employer to pay him *Wallace* damages, plus $10,000 more in aggravated damages [*Terry Schimp v. RCR Catering Ltd. & RCR Pubs Ltd*., 2004 NSCA 29 (CanLII)].

Example: A shopkeeper whose job is eliminated due to restructuring is led from the store as co-workers and customers watch. The Ontario court finds the termination humiliating and awards the shopkeeper $15,000 in *Wallace* damages [*Therrien v. Hock Shop Canada*, [2005] O.J. No. 3303].

Example: Upon arriving to work, an employee is escorted into an isolated room and abruptly informed that she no longer has a job, that her cellphone has been wiped, and that she may not talk to anyone at the company. She's then escorted out of the building. The Ontario court awards the employee $10,000 in Wallace damages for the shock and humiliation she suffered as a result of the company's conduct [*Canadian Broadcasting Corporation v. Association of Professionals and Supervisors*, 2020 ONSC 6531 (CanLII)].

Takeaway: Of course, termination is inherently demeaning and it's almost impossible to completely prevent the employee from experiencing at least some degree of humiliation. But remember that *Wallace* damages aren't about normal humiliation but rather mental distress. You can and should be mindful of and careful to limit the emotional toll of termination by delivering the news in a way that's dignified and devoid of unnecessary embarrassment. At a minimum, you should carry out the process discreetly and **in private**.

Step 5. Keep the Termination Strictly between You & the Employee

Termination should be kept strictly between the company and the employee. The moment you drag other employees into the process, you risk crossing the line between good and bad faith. One common pitfall is overtly and publicly terminating an employee to send a message to others.

Example: A real estate firm seeking to restructure its compensation system asked an agent to sign a new contract that would remove all bonuses. The agent refused. As a result, the firm decided to fire her. In addition to a termination letter, the firm sent out a pager message to all of its other agents stating: "We are sorry to inform you that [the agent] has been terminated from our team for non-production and refusal to accept the new contract terms." The Ontario court trial court ruled that the agency used "unfair" tactics by communicating the termination to the other agents to get them to sign the amended agreement. Adding insult to injury, the allegation that the agent failed to adequately perform her duties was unfounded and damaging to her reputation. The province's top court, the Court of Appeal, upheld the ruling [*Slepenkova v. Ivanov*, 2009 ONCA 526 (CanLII)].

Takeaway: While it's okay and even necessary to let other employees know that a terminated employee no longer works for the company, keep the details, including the reason for termination, confidential. If disclosure is necessary, tell only personnel who need to know the information and limit the disclosure to just the information the employee or other third party needs to accomplish the purpose of the disclosure.

Step 6. Don't Make False Accusations

As an HR director, you know all about the limits of "just cause." You also know that certain forms of misconduct, such as violence, harassment, dishonesty, and fraud

constitute just cause for termination. But what you also need to realize is that you must have some reasonable basis for believing that the employee engaged in such misconduct. Simply believing an unsubstantiated accusation isn't enough and could be construed as bad faith.

Example: A manufacturing company terminated a 53-year-old supervisor who had worked for the company for 30 years without cause. After the termination, the general manager sent a letter to board members falsely accusing the supervisor of theft and threatening staff members. While admitting that the charges were false and unsubstantiated, the company contended that the 8 weeks' termination notice it provided was adequate to compensate the supervisor for termination without cause. But the Saskatchewan court disagreed and ordered the company to pay an additional $20,000 in *Wallace* damages to compensate the supervisor for the mental stress he suffered as a result of its bad faith [*Porcupine Opportunities Program Inc. v Cooper*, 2020 SKCA 33 (CanLII)].

Example: Bank of Nova Scotia fired a manager for various financial and personal improprieties such as giving special deals to family members and having an affair with a mortgage broker client. The Bank did an investigation purporting to substantiate the charges; but the report was full of holes and the evidence was flimsy at best. The Ontario court ruled that the VP who made the decision to fire acted in bad faith by accepting the report at face value, especially given the serious nature of the charges and the manager's 29 years of faithful and distinguished service. Consequently, the court awarded the manager *Wallace* damages [*Mastrogiuseppe v. Bank of Nova Scotia*, 2005 CanLII 46757 (ON SC)].

Takeaway: Investigate and substantiate allegations of wrongdoing before terminating an employee on the basis of them, especially if the employee involved has served your company well. Also, refrain from repeating the accusations to others, even after the employee no longer works for the company. "The duty of good faith and fair dealing is not temporally limited to the moment of dismissal," noted the Saskatchewan court in the *Cooper* case cited above.

Step 7. Be Sensitive to Timing of Termination

Terminated employees arouse great sympathy in the eyes of judges, juries, and arbitrators. Choosing a sensitive or awkward time to deliver the pink slip puts you at risk of looking like a monster in the eyes of the courts.

Takeaway: Be sensitive to timing and what's going on in the personal and professional lives of the employees you're about to terminate. Examples of times to avoid telling employees that they've been terminated, if possible, include:

- On the employee's birthday or anniversary of starting employment with the company;
- Just before the employee is about to go on maternity leave; or
- Right after the employee experiences a physical or emotional crisis, such as a divorce or death in the family.

Step 8. Help or at Least Don't Damage the Employee's Prospects of Finding Another Job

One of the most egregious things an employer can do to open the door to *Wallace* damages is to leave the employee as damaged goods in the eyes of future employers. Examples:

- BC car dealer publishes negative statements about a former salesman in the trade press [*Hamer-Jackson v. McCall Pontiac Buick Ltd*., 2000 BCCA 416 (CanLII)]; and
- Bank blacklists employee and her family members and withdraws previously paid personal loan payments to hurt her credit rating and chances of getting hired by another employer [*Mastrogiuseppe v. Bank of Nova Scotia*, 2005 CanLII 46757 (ON SC)].

Takeaway: If possible, offer to help terminated employees find another job. That might involve providing outplacement services and/or positive references. However, you should also understand that the failure to give a terminated employee a positive reference can be but isn't necessarily bad faith justifying *Wallace* damages. As with other forms of conduct, there are no hard and fast rules. Courts will consider the entire context of the dispute. For example, a BC court ruled that an environmental engineering firm didn't have to pay *Wallace* damages for refusing to provide a reference, particularly since the company wasn't satisfied with the terminated employee's performance [*Ashby v. EPI Environmental Products Inc*., 2005 BCSC 1190 (CanLII)].