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Compensation Management and Canadian Wrongful Dismissal: Lessons from Litigation

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Résumé de l'article

Les litiges en common law canadienne touchant les congédiements abusifs affectent presque tous les aspects de la gestion des ressources humaines, mais cette question n'a guère retenu l'attention des chercheurs. L'objet du présent article est d'analyser la jurisprudence en matière de congédiements injustes traitant des politiques et des pratiques de rémunération (à l'exception de l'appréciation du rendement) afin d'identifier les principes qui s'en dégagent. Les résultats sont fondés sur l'analyse de 110 cas de cette nature, ce qui représente tous les jugements rapportés ou non sur le sujet entre 1980 et 1988.

Selon la common law canadienne, tout salarié est lié avec son employeur par un contrat écrit, verbal ou implicite. Ce contrat est généralement conclu pour une durée indéterminée et l'employeur peut le modifier ou y mettre fin en donnant à son employé un préavis raisonnable ou en lui versant une indemnité équivalente. Le renvoi abusif se produit quand l'employeur congédie le salarié sans préavis ou modifie les conditions de son contrat sans préavis ou cause juste. Les dommages résultant d'un congédiement injuste équivalent aux gains perdus au cours d'une période raisonnable de délai-congé. Dans de rares cas, on accorde aussi une indemnité pour dommages moraux.

Les affaires retenues dans la présente étude ne portent que sur les cas où l'employeur modifie de façon substantielle et unilatérale les conditions de travail d'un employé, ce que l'on désigne habituellement sous le nom de congédiement déguisé (constructive dismissal). Cette jurisprudence ne s'applique toutefois pas aux travailleurs du Québec, ni aux syndiqués car ils sont protégés par les lois du travail et les mécanismes de règlement des griefs dans les conventions collectives. Elle ne s'applique pas non plus aux hauts fonctionnaires, engagés selon bon plaisir, et qui, par conséquent, peuvent être démis sans préavis.

La forme la plus courante de congédiement déguisé se produit lorsque l'employeur, agissant de façon directe et unilatérale, diminue, retire ou retient toute partie appréciable de la rémunération d'un salarié, même s'il pose pareils gestes pour assurer la survie de l'entreprise. De plus, des décisions qui diminuent d'une manière indirecte les gains des employés, telles la réduction de l'étendue d'un territoire de vente, la diminution des heures de travail ou une coupure de personnel peuvent aussi exposer un employeur à poursuite pour violation du contrat de travail.

Le changement dans la forme de la rémunération, par exemple le remplacement du salaire de base par un traitement variable, peut également donner lieu à un congédiement déguisé. Se fondant sur l'examen du niveau de salaire, il y a renvoi si les gains totaux du travailleur sont moins élevés sous le nouveau régime de rémunération.

Reposant sur l'examen de la forme de rémunération, un tel renvoi se produit encore si la nouvelle méthode de rémunération est fondamentalement différente de l'entente antérieure entre les parties. Même si les salariés reçoivent des gains plus élevés suivant la nouvelle méthode, le tribunal peut trancher le litige contre l'employeur

si les risques que ces travailleurs reçoivent des traitements plus faibles dans l'avenir sont plus élevés selon le nouveau régime. C'est le tribunal dans ces instances qui prend la décision de se fonder sur l'examen du niveau de salaire ou de la forme de rémunération selon sa préférence.

La classe de retenue, qui comporte le gel du salaire d'un travailleur jusqu'à ce que la structure de salaire le rejoigne, contrevient au contrat d'engagement parce qu'elle limite le salaire potentiel de l'employé ou parce que celui-ci ne s'y attendait pas ou qu'il ne l'a pas acceptée. Les employeurs peuvent réévaluer les emplois à un échelon inférieur de salaire sans enfreindre le contrat en laissant le traitement des salariés déjà en poste au degré le plus élevé de l'échelle.

En général, les tribunaux ne tiennent pas compte des données relatives à la structure des salaires pour déterminer si un employé a subi une rétrogradation. Même quand un travailleur s'est vu rétrograder à un échelon de traitement plus bas, les tribunaux ont décidé que cela ne constituait pas une preuve suffisante de déclassement professionnel.

Toutefois, dans certains cas, ils ont comparé les traitements de personnes en particulier pour juger si l'employé avait été déclassé.

Les litiges concernant les renvois injustifiés comportaient nombre de questions relatives aux informations divulguées sur les systèmes de rémunération. Lorsque l'employeur et le salarié sont en désaccord au sujet de l'interprétation d'un tel système, les tribunaux préfèrent retenir l'interprétation du salarié. Dans certains cas, l'employeur peut être tenu responsable de congédiement déguisé s'il y a eu promesse d'amélioration du système de rémunération et que la mise en place de ces modalités tarde trop. Enfin, les garanties données aux employés en matière de traitements futurs, de bonis ou autres avantages doivent être remplies s'il y a preuve suffisante de leur existence.

Pour atténuer les risques de litiges, les employeurs doivent d'abord chercher à obtenir l'acceptation du système de rémunération par les travailleurs. Il importe de bien faire connaître les modifications qu'on propose et d'inciter les salariés à participer à la recherche de solutions de nature à corriger les difficultés que subit l'entreprise.

Un autre moyen pour avoir gain de cause consiste à présenter aux travailleurs un nouveau contrat dont les conditions négatives se trouvent en quelque sorte compensées par des conditions positives. Si les employés acceptent la nouvelle entente, ils ne peuvent en rejeter subséquemment les composantes qui ne sont pas à leur goût. Si les salariés ne sont toujours pas d'accord avec le système modifié, on peut exiger de l'employeur qu'il accorde un préavis d'une durée raisonnable avant l'introduction des changements ou qu'il verse une indemnité équivalente. Les employeurs qui ont modifié de façon abusive leur régime de rémunération peuvent recourir à quatre moyens de défense. Premièrement, ils peuvent plaider juste cause en démontrant que l'employé a enfreint son contrat d'emploi par son incompétence ou par son inconduite. Une autre stratégie consiste à soutenir qu'il ne s'agit que d'un changement mineur et non pas d'une violation importante du contrat. Cependant, les tribunaux considèrent généralement la rémunération de l'employé comme un élément essentiel du contrat d'engagement. Troisièmement, quand il y a eu retrait ou diminution de traitement, les employeurs peuvent prétendre, dans certains cas, que le salaire constituait une forme de gratification plutôt qu'une partie intégrante du système de rémunération. Enfin, ils peuvent essayer de prouver que le nouveau régime de rémunération se voulait une simple proposition plutôt qu'une décision définitive.

Compensation Management and Canadian Wrongful Dismissal

Lessons from Litigation

Steven L. McShane
and
Bruce Redekop

This paper analyzed 110 recent Canadian common law wrongful dismissal cases to identify principles pertaining to compensation management policies and practices. All of these cases involve «constructive dismissal», where the employee sues the employer for altering a fundamental condition of employment (other than outright termination). The case law has been divided into four general headings: pay level issues, pay form issues, pay structure issues, and pay communication issues.

The number of Canadians suing for wrongful dismissal has increased so rapidly over the past decade that wrongful dismissal litigation has been called «one of Canada's primary growth industries» (Grosman, 1984, p. ix). These court decisions affect virtually every aspect of the employment relationship, from recruitment and selection to performance and compensation management. While the implications of unjust discharge case law in the United States has been the subject of much writing (Lorber et al., 1984; Stieber, 1980, 1983, 1985; Stieber and Murray, 1983; Youngblood and Bierman, 1985), Canadian wrongful dismissal cases have received relatively lit-

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tle attention by personnel/industrial relations researchers (for exceptions, see: Adams and Donnelly, 1986; McShane, 1983; McShane and McPhillips, 1987; Sooklal, 1986a, 1986b).

The purpose of this paper is to analyze Canadian common law wrongful dismissal cases to identify the principals that apply to compensation management policies and practices. All reported and most unreported decisions[1] between 1980 and 1988 which mentioned some aspect of the employer's wage and salary administration system, as well as several pre-1980 cases cited in other decisions, were reviewed. Performance evaluation issues as well as decisions pertaining to the quantum of damages are not directly discussed here because the volume of case law on these subjects could not be summarized adequately. In total, the full texts of 110 cases were examined, most of which are cited in this paper.

The paper begins with a brief introduction to Canadian common law wrongful dismissal principles. This is followed by a review and analysis of the relevant case law associated with specific compensation management issues. This material is delineated into four general headings: pay level issues, pay form issues, pay structure issues, and pay communication issues. Several preventive strategies and justification arguments are presented in the final section.

BASIC WRONGFUL DISMISSAL PRINCIPLES

A basic principle in Canadian common law is that each employee has a contract with his or her employer (Harris, 1987; Levitt, 1985). Some employment contracts are written, but most consist only of implied terms based on the intentions of the parties, their past employment practices, and certain basic common law principles. The employment relationship has an indefinite term unless the parties agree otherwise. This means that the employer may alter or end the relationship for any reason — or for no reason at all — by giving the employee reasonable notice or equivalent severance. Reasonable notice is an extremely ambiguous issue, however, which has led to many lawsuits even where the employer has attempted to provide advance notice or severance (eg. *Ansari et al. v. B.C. Hydro,* 1986; McShane, 1983; McShane and McPhillips, 1987). Courts have decided reasonable notice as high as 24 months in some situations.

1 Digesting services in the four western provinces publish summaries for all unreported cases in these jurisdictions. Another digesting service, *All Canada Weekly Summaries,* publishes summaries for selected cases throughout Canada.

Wrongful dismissal cases often involve an employer firing or laying off an employee, but the cases in this paper involve a particular form of wrongful dismissal, known as 'constructive dismissal'. Constructive dismissal occurs when the employer unilaterally changes a fundamental condition of the employment relationship (other than outright termination) and the employee seeks damages for breach of contract. The damages awarded for either constructive or wrongful dismissal represent the amount of earnings that the employee would have received during a period of reasonable notice. In rare circumstances, the employer must also pay damages for mental distress. Courts do not have the power to either reinstate the employee or, in cases involving constructive dismissal, to force the employer to return to the original employment conditions.

It is unnecessary to provide reasonable notice or an equivalent severance if the employer has 'just cause' to dismiss the employee or alter the employment relationship. Just cause includes evidence of misconduct, unfaithful service (such as conflict of interest), or gross incompetence. Just cause is often difficult to prove, however, and *does not* include layoffs even when the employer must reduce wage costs due to an economic downturn.

Not everyone employed in Canada is protected by common law wrongful dismissal. Employees in Québec are protected by civil code rather than common law, although there are similarities. Unionized employees are also excluded from common law wrongful dismissal actions because they are protected by labour laws and grievance procedures. However, one court recently allowed union members to seek common law wrongful dismissal damages because the employer altered conditions promised outside of the collective agreement (*Wainwright v. Vancouver Shipyard Company,* 1987). Finally, senior government administrators are employed 'at the pleasure of the Crown', meaning that they are subject to employment-at-will rather than reasonable notice.

PAY LEVEL ISSUES

One of the clearest forms of constructive dismissal occurs when the employer unilaterally and directly reduces, withdraws, or withholds any significant part of the employee's remuneration. Even when the firm faces financial hardship, the level of remuneration cannot be altered without giving the employee reasonable notice. The relevant cases since 1980 as well as significant earlier decisions are cited in Table 1.

Table 1

Cases Involving Reduced, Withdrawn, or Withheld Remuneration

Directly Reducing Fixed Salaries
Farquhar v. Butler Brothers Supplies Ltd. (1988)
Hendry v. J.V. Harbord Company Ltd. (1986)
Olson v. Sprung Instant Greenhouses Ltd. et al. (1985)
Pridham v. Saint John Building and Construction Trades Council (1985, 1986)
Wallace v. Toronto Dominion Bank (1981, 1983)

Directly Reducing Commissions/Bonuses
Bell et al. v. Trail-Mate Products of Canada Ltd. (1986)
Dunse v. Quadra Wood Products Ltd. (1983)
Schellenberg v. Marzen Artistic Aluminum Ltd. (1986)

Reducing Salaries Due to a Job Transfer
Bening v. Ebco Industries Ltd. (1987)
Brown v. OK Builders Supplies Ltd. (1985a, 1985b)
Coyes v. Ocelot Industries Ltd. (1984)
Green v. Electronics for Medicine Canada Ltd. and Honeywell Ltd. (1982)
Lynch & Jay v. Richmond Plymouth Chrysler Ltd. (1985)
Pearl v. Pacific Enercon Inc. (1985)
Roberts v. Versatile Farm Equipment et al. (1987)
Robinson v. Tingley's Ltd. (1988)
Scott v. Irving Oil Limited (1984)
Young v. Huntsville District Memorial Hospital et al. (1984)

Indirectly Reducing Employee Remuneration
Gillespie v. Ontario Motor League Toronto Club (1980)
Smith v. Tamblyn (Alberta) Ltd. (1979)
Springer v. Merrill Lynch, Royal Securities Ltd. (1984)
Vassallo v. Crosbie Enterprises Ltd. (1981)

Withdrawing Employee Remuneration
Allison v. Amoco Production Company (1975)
Bell et al. v. Trail-Mate Products of Canada Ltd. (1986)
Brown v. OK Builders Supplies Ltd. (1985a, 1985b)
Farquhar v. Butler Brothers Supplies Ltd. (1988)
Nerada v. Hobart Canada Inc. (1982)
Roberts v. Versatile Farm Equipment et al. (1987)
Tingle v. Bird Construction Co. Ltd. (1983)

Withholding Employee Remuneration
Colasurdo v. CTG Inc. et al. (1988)
Hill v. Peter Gorman Ltd. (1957)
Luchuk v. Sport B.C. (1984)
Prozak et al. v. Bell Telephone Co. of Canada (1982, 1984)
Stott v. Merit Investment Corporation (1985)
Wansborough v. N.W.P. Northwood Products Ltd. (1983)

These points are effectively illustrated in *Farquhar v. Butler Brothers Supplies Ltd.* (1988). To alleviate its financial difficulties, Butler Brothers decided to reduce all employee salaries. Farquhar received a letter stating that his salary as credit and office manager would be reduced from $3,600 to $2,400 per month and that his $5,000 fee as a director of the company would no longer be paid. His motor vehicle benefit would also be withdrawn. The employer argued that its decision to reduce employee salaries was justified because without the cooperation of other staff the company may have gone out of business. The court explained, however, that mutual consent is required for all significant changes in the employment contract and the employer's financial well-being does not alter this condition unless the implied or explicit contract permits.

Courts will also arrive at a decision of constructive dismissal when the employee receives a pay decrease resulting from a job transfer (see Table 1). Even when an employee requests a job with less responsibility, the employer may have difficulty decreasing the salary accordingly. This point was raised in *Brown v. OK Builders Supplies Ltd.* (1985a, 1985b) where a senior executive requested a transfer to the newly-created position of systems analyst in order to manage the design of the firm's new computer system and reduce his level of work responsibilities. There was no discussion regarding salary or benefits in the new position. After agreeing to the request, the company conducted an informal survey of systems manager salaries in the area and, based on this information, reduced the employee's salary by $12,000 per year. The employee was also asked to return the company car.

In its decision that Brown had been constructively dismissed, the lower court noted that there was no implied condition regarding a change in salary because the issue had never been discussed. Arriving at the same conclusion, the court of appeal added that a change in salary could not be implied by the transfer because the firm had an informal salary structure with salaries attached as much to individuals as to jobs.

With respect to withholding some part or all of the employee's remuneration, several courts have rejected the argument that such an action is part of a legitimate business interest (see Table 1). The benchmark decision on this issue is *Hill v. Peter Gorman Ltd.* (1957) where the employer wrongfully withheld ten percent of commissions earned by the employee and other sales people as a reserve for bad debts.

Courts have also been sympathetic to employees whose opportunity to receive future income has been limited by the employer's actions. This is illustrated in *Prozak* where two industrious employees designed and were on the verge of completing the sale of a long distance telephone service to the

Ontario and Canadian governments. Realizing the extraordinary commissions that would be generated from these sales, the company transferred both employees to salaried jobs in different divisions of the company before either could earn any commissions from their two-year effort. Both the lower and appeal courts ruled that the employees were entitled to receive commissions on sales generated during the 18 months following their transfer (the period of reasonable notice). This amounted to over $300,000 in commissions for each employee.

Indirect Pay Level Changes

Employers have unwittingly violated the employment contract by indirectly altering the employee's level of remuneration (see Table 1). This occurred in *Vassallo* where the size of the territory within which the employee received commissions was reduced, as well as in *Smith* where the employee was offered fewer hours of work. In *Springer,* a senior institutional broker was constructively dismissed because the firm's decision to transfer him to retail sales would have resulted in lower commissions until he built up new clientele. A more complex example of indirectly reducing pay is reported in *Gillespie v. Ontario Motor League Toronto Club* (1980) where an automobile club decided to reduce the number of salespeople under the marketing director's supervision. The court decided that the employer had violated the employment contract partly because the marketing director's annual bonus was based on new membership sales and this would be adversely affected by the staff cutbacks.

PAY FORM ISSUES

Changing the form of remuneration may result in constructive dismissal, depending on the circumstances as well as the test used by the court. Two distinct tests appear to have developed, although they are described here for the first time. One test, which we call the *pay level test,* examines the impact of the change on the level of the employee's salary. Constructive dismissal occurs only if the court finds that the employee's earnings would decrease under the new plan. The other test, which we call the *pay form test,* examines whether the form of the new compensation package is fundamentally different from the previous arrangement. Even if the employee potentially benefits from the change, courts applying this test will decide against the employer, particularly if the financial gain is not certain. Whether the court applies the pay level or pay form test appears to

depend on its interpretation of previous case law rather than a specific contingency factor. The recent cases pertaining to pay form issues are listed in Table 2.

Table 2

Cases Involving Altered Remuneration

From Variable* to Fixed Remuneration: Pay Level Test
Conway v. George's Farm Centre Ltd. (1986)
Luchuk v. Sport B.C. (1984)
Oxman v. Dustbane Enterprises Ltd. (1986)
Pearl v. Pacific Enercon Inc. et al. (1985)

From Fixed to Variable* Remuneration: Pay Level Test
Brown v. Morden & Helwig Limited (1984)
George v. Morden & Helwig Ltd. (1988)
George v. Muller Sales & Services Ltd. (1984)
Islip v. Northmount Food Services Ltd. (1988)
Kendall v. Jamieson Management Corporation (1984)
Lynch and Jay v. Richmond Plymouth Chrysler Ltd. (1985)
Rebitt v. Pacific Motors Sales & Service Ltd. (1987, 1988)

From Fixed to Variable* Remuneration: Pay Form Test
Hart v. Bogardus Wilson (1986, 1987)
Lewis v. Auto Marine Electric (1985)
McLeod v. Gestas Inc. (1984)
Tymrick v. Viking Helicopters Ltd. (1985)

* A guaranteed (fixed) base pay level may represent a portion of variable remuneration.

Pay Level Test

The pay level test has been applied in all reviewed cases where the compensation package has been changed to a fixed salary from one that included a variable form of pay (eg. base pay with bonus or commission). Employers have won these lawsuits only when it was clearly shown that the fixed salary was equal to or greater than the previous year's earnings under the more variable form of remuneration. Even if the fixed salary arrangement limited the employee's potential earnings, the employer's action has not resulted in constructive dismissal under the pay level test.

When a more variable form of compensation replaces a fixed salary, courts applying the pay level test have compared the fixed salary with estimated earnings under the new variable remuneration plan. The

employer's actions are wrongful where estimated earnings are lower under the new plan. In *Rebitt,* for example, the new owner of Pacific Motors intended to reduce the sales manager's fixed salary by 50 percent and to introduce a commission based on gross business profits. The court of appeal found that the employee had been constructively dismissed because sales would have to increase by 50 percent in order to earn the same as under the previous arrangement.

Pay Form Test

The pay form test has been applied only where some or all of the employee's fixed salary has been replaced with a variable form of compensation. This test was applied in *Hart* where the company decided to combine certain jobs and pay the incumbents $20,000 per year plus a commission. The firm calculated that employees would earn more than their previous fixed salary of $30,000 and, in fact, earnings ranged between $36,000 and $48,000 during the first year of the plan. Nevertheless, both the lower and appeal courts agreed that the new form of remuneration was fundamentally different from the previous arrangement and, consequently, the employer's action constituted a breach of contract.

Courts applying the pay form test will also decide that this action constitutes constructive dismissal because the employee has lost the certainty of earnings. In *Tymrick,* for example, the court decided against the employer because «while the plaintiff's salary as a project manager was certain, as a pilot-engineer it would have fluctuated with the amount of flying time available to him» (p. 230). In *Lewis,* the court noted that while the new pay system increased the earnings of those who accepted the change, it might also result in lower earnings in some months. The certainty of earnings comprises an important aspect of the pay form test and may explain why the test has not been applied to situations where the employee replaces a variable compensation plan with a fixed salary.

PAY STRUCTURE ISSUES

An increasing number of cases have looked at evidence regarding the firm's salary structure to determine whether the employee has been constructively dismissed. Several decisions concern red-circling while others mention the pay structure as evidence (or lack of) that the employee has been demoted, thereby entitling the employee to damages for breach of the employment contract. The list of cases addressing these pay structure issues is presented in Table 3.

Table 3

Cases Involving the Pay Structure

Job Reclassification with Red-Circling
Bower v. J.M. Schneider Inc. (1984)
Burgess v. Central Trust Co. (1988)
Cole v. Dresser Canada Ltd. (1983)
Dibbin v. Canada Trust Co. (1988)
Jobber v. Addressograph Multigraph of Canada Ltd. (1980)
Malone v. The Queen in Right of Ontario (1983)
Taylor v. Canadian Broadcasting Corporation (1984)
*Tingle v. Bird Construction Co. Ltd.** (1983)

Job Reclassification without Red-Circling
Belyea v. New Brunswick Telephone Company (1988)
Hall v. Constellation Assurance Company (1987)
Longman v. Federal Business Development Bank (1982)
Mifsud v. MacMillan Bathurst Inc. (1987)
Moore v. University of Western Ontario (1985)

Pay Structure Evidence of Demotion
Belyea v. New Brunswick Telephone Company (1988)
Buchanan v. Canada Valve Inc. et al. (1987)
Hall v. Constellation Assurance Company (1987)
Longman v. Federal Business Development Bank (1982)
McKilligan v. Pacific Vocational Institute (1979, 1981)
Mifsud v. MacMillan Bathurst Inc. (1987)
Moore v. University of Western Ontario (1985)
Reber v. Lloyds Bank International Canada (1983, 1985)

* Red-circling is inferred rather than explicitly stated in *Tingle* because the salary was frozen when the employer demoted the employee to a less senior position.

Job Reclassification and Red-Circling

Several Canadian court decisions have concluded that red-circling may expose the employer to liability for constructive dismissal. Red-circling, which involves freezing an employee's salary until the pay range comes into line with his or her current salary (Belcher and Atchison, 1987), has been conducted in the reviewed cases for one of two reasons. First, the employee's job may have been reevaluated to a lower pay grade, placing the current salary above the maximum rate of the new pay grade. Alternatively, the employee may have been transferred to a job in a lower pay category, again often resulting in a pay rate higher than the maximum of the new pay grade.

Red-circling potentially violates the employment contract because it limits the employee's potential salary and because the salary freeze was neither expected nor accepted by the employee. For example, the court in *Malone* commented that under red-circling the employee «would not lose salary immediately, (but) the potential economic loss projected over his working and retirement life is dramatic» (p. 209). On the second argument, the court in *Dibbin* explained that red-circling and the resulting salary freeze is wrongful because it is «reasonable for him to expect that a good appraisal in 1986 should warrant a salary increase, acknowledging those were not guaranteed» (p. 123).

Notwithstanding these decisions, there may be circumstances involving red-circling where the courts will decide in favour of the employer. A New Brunswick court recently accepted red-circling where the employee's absenteeism had frustrated the existing employment relationship (*Burgess v. Central Trust Co.*, 1988). And in *Bower,* the court indirectly suggested that red-circling is permissible when the employee agrees to this compensation action and its implications. Finally, it is hypothetically possible that red-circling in some circumstances may not constitute a fundamental breach of contract. For example, red-circling might be accepted by some courts if it results in only a one-year salary freeze with minimal prejudice of the employee's future earnings potential.

Table 3 lists several cases indicating that jobs may be re-evaluated to a lower pay grade as long as affected employees remain in the higher pay grade[2]. In *Longman,* the employee was transferred to a job in a lower pay grade but was advised that «he would receive the usual cost of living and merit pay raises regardless of the position he occupied» (p. 537). Similarly in *Belyea,* the court concluded that while the new job was classified at $130 less per month, the firm had not constructively dismissed the employee because she was guaranteed «the same salary, with no loss of benefits, and that all increases which attach to her present job would carry forward with this new position» (p. 6).

Evidence of Demotion

The pay structure has been mentioned in several court cases when considering whether the employee has been demoted. In particular, the

2 The employer in *Longman v. Federal Business Development Bank* (1982) called this action «red-flagging», but Belcher and Atchison (1987, p. 248) indicate that this term means the same as «red-circling».

employee argues that the job has moved to a lower pay grade and, while the salary has not altered, the lower grade reflects the job's diminished position and status in the organization.

This pay structure argument has been reviewed by several courts, but most decisions (see Table 3) have given it little weight, preferring instead to consider a change in rank or responsibilities as evidence of demotion (in particular, see: *Belyea v. New Brunswick Telephone Company* (1988); *Hall v. Constellation Assurance Company* (1987); *Longman v. Federal Business Development Bank* (1982); *Moore v. University of Western Ontario,* (1985); *Reber v. Lloyds Bank International Canada* (1983, 1985)).

This situation is illustrated in *Hall* where a vice-president's position was divided into two new positions, one of which the incumbent reluctantly accepted. The personnel department's job evaluation placed the new positions in Grade 15 of the salary structure whereas the former job had been rated in Grade 16. Although the employee presented this information as evidence that she was demoted, the court preferred other evidence that the new position would be at least equal to the previous one and that, in spite of the job evaluation rating, she would remain in Grade 16.

Salary structure information was given greater importance in *Mifsud.* The employee had been transferred from the position of superintendent to foreman, but the court found no evidence from the compensation system that the employee had been demoted because «there is an overlap of the salary scales of the foremen and the superintendents» (p. 23). At the time of transfer, the employee's salary as superintendent was $3,167 per month whereas the pay grade for foreman ranged from $2,915 to $3,860 per month. In other words, the fact that Mifsud was now in a lower pay grade did not convince the court that the employee had been demoted. The judge did decide on other grounds, however, that the employee had been constructively dismissed.

While courts are not easily convinced by salary structure information that an employee has been demoted, they do tend to support this argument when comparing salaries of specific employees in different jobs. At least two decisions have compared the salaries of specific managers to determine whether the employee was demoted. In *McKilligan,* the court concluded that McKilligan had been demoted because his salary remained the same following a corporate reorganization while the salaries of another manager at the same rank and two managers at the rank below received salaries between $4,000 and $6,000 above the plaintiff's. In *Buchanan,* an American firm purchased Canada Valve, creating a separate division for distribution activities and integrating the manufacturing activities into its own. The

former president of Canada Valve was placed in charge of the distribution division but claimed that this was a demotion because the manufacturing responsibilities were more important. The court decided that the distribution position was more important «in a very concrete way» because the employee was offered almost $20,000 more than the person responsible for manufacturing activities.

PAY COMMUNICATION ISSUES

Wrongful dismissal litigation has addressed a variety of issues regarding communicating the compensation package. In particular, problems have resulted when the compensation package is ambiguously stated, when some aspects of future remuneration have not been decided, or when the employer has failed to fulfill previously stated promises. The recent cases addressing these issues are presented in Table 4.

Table 4

Cases Involving Pay Communication Issues

Ambiguous Compensation Formula or Conditions
B & C List Ltd. v. Donald Lobb (1983)
Barkman v. A.E.I. Telecommunications (Can.) Ltd. (1986)
Bower v. J.M. Schneider Inc. (1984)
Cardwell v. Young Manufacturing Inc. (1988)
Fletcher v. Cliffcrest Enterprises Ltd. et al. (1985)
Graham v. The Bella Bella Community School Board (1985)
Luchuk v. Sport B.C. (1984)
Malinowski v. Nault Sawmill & Lumber Co. Ltd. (1985)
Prorep Ltd. v. Canasus Communications Inc. & MacLachlan (1985)

Unsettled Remuneration Promises
Hunt v. Cimco Ltd. (1976)
Page v. Jim Pattison Industries Ltd. (1982, 1984)
Colasurdo v. CTG Inc. et al. (1988)

Unfulfilled Remuneration Promises
Colasurdo v. CTG Inc. et al. (1988)
Graham v. The Bella Bella Community School Board (1985)
Martin v. Corporation of the City of Woodstock (1979, 1980)
Poole v. Tomensen Saunders Whitehead Limited (1985)
Wilcox v. Philips Electronics Ltd. (1984)
Zinman v. Hechter et al. (1981)

Ambiguous Remuneration Formula or Conditions

Several employees have successfully sued for constructive dismissal because their employees introduced an incentive plan or employee benefit without sufficiently detailed formulae or conditions. In each case, the employment contract was breached when the employer attempted to apply its interpretation whereas the employee had different expectations regarding the formula or conditions. Each decision states unequivocally that it is the employer's duty to clearly communicate all aspects of the compensation package.

This point is illustrated in *Malinowski* where the employee did not realize that he had forfeited his entire annual profit-sharing bonus by quitting his job before the end of the year. The court ruled that the employee was entitled to a prorated share of the bonus because the payment «was such an important part of an employee's annual compensation that there an obligation on the company to make it clear» that the restriction applied (p. 336). A slightly different ambiguity arose in two cases (*B & C List Ltd.* and *Prorep Ltd.*) where the employer made regular payments to the employee as an advance against commissions, whereas the employee thought the money represented a salary in addition to commissions. Both decisions favoured the employee because, once again, it was the employer's obligation to clarify an ambiguous arrangement.

Courts use objective evidence rather than the employee's subjective judgement to decide whether the compensation arrangement is ambiguous. In *Graham,* for example, the employee quit her job after receiving a written memorandum from the school board which she interpreted as saying that her $42,000 salary had been reduced to $40,000 for the next six months. In fact, the letter was referring to the average of her past year's earnings and was offering an increase for the next year. The court decided that the employee's interpretation of the letter was not reasonable and that her resignation was too hasty.

Unsettled Remuneration Promises

Under certain conditions, the employer may be liable for constructive dismissal if the employee is promised an improved compensation package but the details of the package are not forthcoming. This occurred in *Hunt* where an employee refused a transfer to another city until the employer made a firm commitment regarding the amount of the promised pay increase. The court concluded that while the employer did promise a salary

as good or better than the existing remuneration, the employee was placed in an intolerable position because he had to sell his home and move his family without a clear idea of his new pay level. In *Page,* however, the court of appeal decided in favour of the employer because at no time prior to the transfer did the employee try to finalize the compensation package. The employee had also accepted his previous transfer before the new salary arrangement was finalized.

Somewhat different circumstances were considered in *Colasurdo.* Colasurdo refused his new compensation package because the performance standards upon which his executive bonus would be calculated had not yet been defined. Colasurdo's superior claimed that he had attempted to put together a package that would pay more than the previous year, but the court felt it was unreasonable for Colasurdo to accept the offer 'on faith' because other evidence suggested that senior management was trying to force him out of the company.

Unfulfilled Remuneration Promises

Promises made to employees with respect to future salaries, bonuses, or other remuneration must be fulfilled if there is sufficient evidence that the promises existed (see Table 4). This type of situation is reported in *Martin* where the City of Woodstock refused to maintain the fire chief's salary at a rate above 160 percent of a first-class fire fighter salary. The court ruled against the employer because it had agreed to this arrangement when the employee was hired. Indeed, the employee had stressed this salary arrangement as a condition of employment.

One of the most unique promises considered in Canadian wrongful dismissal litigation is found in *Zinman.* Since 1953, the employer encouraged the employee to continue working at substandard rates of pay on the promise that he would be compensated with an additional sum of money when the business was sold. The amount of this additional payment was not specified, but when the business was sold in 1978, the employer transferred to the employee's possession a house valued at $17,000. The employee, who was earning only $9,000 per annum at the time, sued for a larger payment. The Manitoba Court of Appeal decided that such a vague promise may not be enforceable over such a long time period, but the employer nevertheless is obliged to pay reasonable remuneration for services rendered under an unenforceable contract (a principle known as *quantum meruit*). Based on the testimony of a Canadian government labour market expert that the employee's salary should have been between $25,000 and $35,000 in 1979, the court decided the employee had been underpaid by over $100,000 and should be awarded that amount.

Courts must occasionally distinguish between a promise and the employee's wishful interpretation of the employer's promise. As an example, in *Poole,* the employer promised that Poole «would not be out of pocket» by moving from Toronto to Vancouver. The cost-of-living was somewhat higher in Vancouver at the time, and the employee interpreted this statement as the employer's promise to pay a cost-of-living differential as well as provide a guaranteed salary. The court rejected this interpretation as wishful thinking.

PREVENTIVE STRATEGIES AND JUSTIFIED ACTIONS

It is abundantly clear from the Canadian case law that employers must consider the common law rights of employees when managing the compensation system. However, steps may be taken to avoid wrongful dismissal litigation and, in the event that the compensation system has been altered and the employee seeks damages for this breach, the employer may consider certain arguments to justify such actions.

Preventive Strategies

The most straightforward method of avoiding wrongful dismissal liability is to seek the employee's consent to the new employment contract. Consent to the new contract should be explicit rather than inferred from lack of objection because courts will allow employees a reasonable time to test the new arrangement (*Tingle v. Bird Construction Co. Ltd.,* 1983).

The method of communicating the new compensation plan may affect the probability that the employee will accept the new employment condition. In several cases, for example, management brought about a sufficient degree of surprise that the opportunity to secure employee consent on the arrangement would have been almost impossible (*Dibbin v. Canada Trust Co.,* 1988; *Dunse et al. v. Quadra Wood Products Ltd.,* 1983; *George v. Muller Sales & Services Ltd.,* 1984). While the concept of surprise is typically discussed within the context of newcomer socialization (Louis, 1980), it applies equally well to any situation involving organizational or personal change. Surprise may be positive, but it is invariably negative in wrongful dismissal cases because the employee perceives the new compensation package as less favorable than the previous arrangement. Negative surprise may create strong resistance to the change and quickly undermine any trust which would otherwise facilitate consent.

The impact of surprise on wrongful dismissal is amply illustrated in *Dunse et al. v. Quadra Wood Products Ltd.* (1983). Due to a rapidly deteriorating lumber market, the employer announced that the traders' commission rates would be significantly reduced and possibly wiped out completely if they eroded the company's normal profits. The new plan was announced with such finality and without warning that the entire trading staff threatened to quit. Three of the traders actually did submit their resignations, but the court decided that this was a response to the employer's action and awarded damages for constructive dismissal.

Increased employee participation may reduce surprise and increase employee commitment to the new compensation arrangement. Inviting employees to participate in finding solutions to the employer's difficulties could reduce resistance to a new compensation plan as employees better understand the need for reform (Lawler, 1981). Surprise may be minimized because employees become aware of the problem before the effect on their employment contract is apparent.

Another plausible strategy is to seek compliance with the new compensation plan by presenting a new contract with both favorable and unfavorable components. If employees accept the new arrangement, they cannot subsequently reject the component which is not to their liking (*King v. Solna Offset of Canada Ltd.*, 1984).

It is almost trite to suggest that employers clearly communicate pay information to their employees in order to avoid problems associated with ambiguous compensation plans. Yet, as previously described, several wrongful dismissal cases have resulted from the employer's failure to ensure a mutual understanding of the compensation package. New incentive plans must be carefully thought out and described so that both parties have the same interpretation of the incentive formula (see, for example, *Cardwell*).

When introducing a new compensation system, it may also be advisable for employers to emphasize that the new arrangement is 'experimental' and can be changed or clarified at any time. This condition was considered in *Barkman v. A.E.I. Telecommunications (Can.) Ltd.* (1986), where the employer introduced a sales incentive plan with bonuses calculated on gross sales exceeding a minimum value. When calculating bonuses at the end of the plan's first year, however, the employer adjusted gross sales by actual gross margins. This resulted in a smaller bonus than the original formula because sales of Japanese products, which provided the lowest gross margin, represented one-half of the sales volume ($4.2 million compared with an expected value of only $100,000). The court decided that the employer had a right to modify the 'experimental' incentive plan *during* the fiscal period, but not after that period had expired.

If the above-mentioned strategies are unsuccessful, it may be advisable to give employees reasonable notice that a new remuneration arrangement is being introduced. Otherwise, employers may prefer to avoid any changes which would possibly violate the employment contract. Giving reasonable notice may not be practical when the employer must implement the new system quickly because courts would require that long service and senior ranked employees receive up to two years notice. Leaving the compensation system unchanged is not practical when changes are essential (as in *Farquhar*), but, as described earlier, this option has certainly been an effective alternative in cases involving red-circling.

Justifying Compensation Changes

In the event that an employer has unilaterally changed some aspect of the compensation system, four justifications may be considered. First, where just cause for dismissal is shown, the employee may be reassigned to another job at a lower rate of pay (*Atkinson v. Boyd, Phillips & Co. Limited,* 1979). This argument has rarely been applied, however, because the employer either does not wish to keep an incompetent or dishonest employee on the payroll in any position or has difficulty proving just cause (as in *Roberts v. Versatile Farm Equipment et al.,* 1987).

The employer's action may also be justified if the change does not amount to a fundamental breach of the employment contract. On this point, the court of appeal in *Poole v. Tomenson Saunders Whitehead Limited* (1987) stated that nonpayment of part of an employee's salary must be accompanied by other evidence that the employer absolutely refused to perform the contract. In *Poole,* the employee's bonus was reduced from 15 percent to 10 percent of salary, partly due to a misunderstanding between the parties. This argument has rarely been successful in other circumstances, however. For example, one court decided that the sale of a pick-up truck that an employee used only to drive to and from work was a fundamental breach of that employee's contract (*Nerada v. Hobart Canada Inc.,* 1982). The court in *Farquhar* also emphasized that the employee's salary goes to the root of the contract.

We could find no cases which raised the fundamental breach argument in situations where the employer altered the compensation package. Such a defence could possibly be used, although the argument would depend on the test applied by the court. With a pay level test, the employer must argue that the employee's total remuneration will not be significantly reduced. Under the pay form test, however, the employer must argue three points, namely,

that the employee's total remuneration will not be (1) significantly reduced, (2) significantly different in form, and (3) significantly more variable.

The third justification, which applies to the employer's ability to withdraw some aspect of the employee's remuneration, is that the withdrawn remuneration was a gratuity rather than an integral part of the compensation package. Again, this argument has rarely been successful. In general, courts will view remuneration as a gratuity only if no regular pattern of receiving it has developed (*Brock v. Matthews Group Ltd. et al.*, 1988; *Duplessis v. Irving Pulp and Paper Ltd., J.D. Irving Limited and Irving*, 1982; *Gillespie v. Ontario Motor League Toronto Club*, 1980; *Malinowski v. Nault Sawmill & Lumber Co. Ltd.*, 1985).

Finally, the employer might attempt to show that the new compensation plan was a proposal rather than a final decision (*Dunse v. Quadra Wood Products Ltd.*, 1983; *George v. Morden & Helwig Ltd.*, 1988; *George v. Muller Sales & Services Ltd.*, 1984; *Meyer v. Steintron International Electronics Ltd.*, 1979). Whether this argument averts a constructive dismissal decision depends on the extent to which the new compensation package is presented tentatively to the employee and the extent to which the employee discusses the matter with the employer before leaving the job.

CONCLUSIONS

The compensation system can be a powerful instrument to help managers direct employees toward organizational goals, enhance employee satisfaction, and shape organizational values (Lawler, 1981; Schein, 1985). Yet it is abundantly clear from Canadian wrongful dismissal case law that employers cannot change the compensation package as easily as they may wish.

Courts will typically decide that constructive dismissal has occurred where the employer reduces, withdraws, or withholds some aspect of the compensation package. A new pay arrangement resulting in a probable pay increase may be inappropriate if the change includes a more variable form of compensation. Even where the employee's actual salary is unchanged but potential salary is restricted — as in red-circling — the employee may successfully sue for constructive dismissal.

Attempts to correct or clarify an ambiguous remuneration package may also constitute a breach of the employment contract. Failing to provide the details of a promised future salary increase may have the same result under certain conditions. Finally, employers are obliged to fulfill remuneration promises when there is sufficient evidence that those promises existed.

This paper has examined the implications of Canadian wrongful dismissal case law for compensation management. Yet this is only a small beginning in a subject which has much to offer researchers as well as human resource management practitioners. For example, dozens (possibly hundreds) of cases pertain to career management issues while others address performance management, absenteeism, and organizational recruitment practices. Careful analysis of these decisions will certainly benefit both employers and employees by identifying human resource management activities which do not infringe on the employee's common law rights.

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La gestion de la rémunération et les congédiements abusifs: leçons de la jurisprudence canadienne

Les litiges en *common law* canadienne touchant les congédiements abusifs affectent presque tous les aspects de la gestion des ressources humaines, mais cette question n'a guère retenu l'attention des chercheurs. L'objet du présent article est d'analyser la jurisprudence en matière de congédiements injustes traitant des politiques et des pratiques de rémunération (à l'exception de l'appréciation du rendement) afin d'identifier les principes qui s'en dégagent. Les résultats sont fondés sur l'analyse de 110 cas de cette nature, ce qui représente tous les jugements rapportés ou non sur le sujet entre 1980 et 1988.

Selon la *common law* canadienne, tout salarié est lié avec son employeur par un contrat écrit, verbal ou implicite. Ce contrat est généralement conclu pour une durée indéterminée et l'employeur peut le modifier ou y mettre fin en donnant à son employé un préavis raisonnable ou en lui versant une indemnité équivalente. Le renvoi abusif se produit quand l'employeur congédie le salarié sans préavis ou modifie les conditions de son contrat sans préavis ou cause juste. Les dommages résultant d'un congédiement injuste équivalent aux gains perdus au cours d'une période raisonnable de délai-congé. Dans de rares cas, on accorde aussi une indemnité pour dommages moraux.

Les affaires retenues dans la présente étude ne portent que sur les cas où l'employeur modifie de façon substantielle et unilatérale les conditions de travail d'un employé, ce que l'on désigne habituellement sous le nom de congédiement déguisé *(constructive dismissal)*. Cette jurisprudence ne s'applique toutefois pas aux travailleurs du Québec, ni aux syndiqués car ils sont protégés par les lois du travail et les mécanismes de règlement des griefs dans les conventions collectives. Elle ne s'applique pas non plus aux hauts fonctionnaires, engagés selon bon plaisir, et qui, par conséquent, peuvent être démis sans préavis.

La forme la plus courante de congédiement déguisé se produit lorsque l'employeur, agissant de façon directe et unilatérale, diminue, retire ou retient toute partie appréciable de la rémunération d'un salarié, même s'il pose pareils gestes pour

assurer la survie de l'entreprise. De plus, des décisions qui diminuent d'une manière indirecte les gains des employés, telles la réduction de l'étendue d'un territoire de vente, la diminution des heures de travail ou une coupure de personnel peuvent aussi exposer un employeur à poursuite pour violation du contrat de travail.

Le changement dans la forme de la rémunération, par exemple le remplacement du salaire de base par un traitement variable, peut également donner lieu à un congédiement déguisé. Se fondant sur l'examen du niveau de salaire, il y a renvoi si les gains totaux du travailleur sont moins élevés sous le nouveau régime de rémunération. Reposant sur l'examen de la forme de rémunération, un tel renvoi se produit encore si la nouvelle méthode de rémunération est fondamentalement différente de l'entente antérieure entre les parties. Même si les salariés reçoivent des gains plus élevés suivant la nouvelle méthode, le tribunal peut trancher le litige contre l'employeur si les risques que ces travailleurs reçoivent des traitements plus faibles dans l'avenir sont plus élevés selon le nouveau régime. C'est le tribunal dans ces instances qui prend la décision de se fonder sur l'examen du niveau de salaire ou de la forme de rémunération selon sa préférence.

La classe de retenue, qui comporte le gel du salaire d'un travailleur jusqu'à ce que la structure de salaire le rejoigne, contrevient au contrat d'engagement parce qu'elle limite le salaire potentiel de l'employé ou parce que celui-ci ne s'y attendait pas ou qu'il ne l'a pas acceptée. Les employeurs peuvent réévaluer les emplois à un échelon inférieur de salaire sans enfreindre le contrat en laissant le traitement des salariés déjà en poste au degré le plus élevé de l'échelle.

En général, les tribunaux ne tiennent pas compte des données relatives à la structure des salaires pour déterminer si un employé a subi une rétrogration. Même quand un travailleur s'est vu rétrograder à un échelon de traitement plus bas, les tribunaux ont décidé que cela ne constituait pas une preuve suffisante de déclassement professionnel. Toutefois, dans certains cas, ils ont comparé les traitements de personnes en particulier pour juger si l'employé avait été déclassé.

Les litiges concernant les renvois injustifiés comportaient nombre de questions relatives aux informations divulguées sur les systèmes de rémunération. Lorsque l'employeur et le salarié sont en désaccord au sujet de l'interprétation d'un tel système, les tribunaux préfèrent retenir l'interprétation du salarié. Dans certains cas, l'employeur peut être tenu responsable de congédiement déguisé s'il y a eu promesse d'amélioration du système de rémunération et que la mise en place de ces modalités tarde trop. Enfin, les garanties données aux employés en matière de traitements futurs, de bonis ou autres avantages doivent être remplies s'il y a preuve suffisante de leur existence.

Pour atténuer les risques de litiges, les employeurs doivent d'abord chercher à obtenir l'acceptation du système de rémunération par les travailleurs. Il importe de bien faire connaître les modifications qu'on propose et d'inciter les salariés à participer à la recherche de solutions de nature à corriger les difficultés que subit l'entreprise. Un autre moyen pour avoir gain de cause consiste à présenter aux travailleurs un nouveau contrat dont les conditions négatives se trouvent en quelque sorte compensées par des conditions positives. Si les employés acceptent la nouvelle entente, ils

ne peuvent en rejeter subséquemment les composantes qui ne sont pas à leur goût. Si les salariés ne sont toujours pas d'accord avec le système modifié, on peut exiger de l'employeur qu'il accorde un préavis d'une durée raisonnable avant l'introduction des changements ou qu'il verse une indemnité équivalente.

Les employeurs qui ont modifié de façon abusive leur régime de rémunération peuvent recourir à quatre moyens de défense. Premièrement, ils peuvent plaider juste cause en démontrant que l'employé a enfreint son contrat d'emploi par son incompétence ou par son inconduite. Une autre stratégie consiste à soutenir qu'il ne s'agit que d'un changement mineur et non pas d'une violation importante du contrat. Cependant, les tribunaux considèrent généralement la rémunération de l'employé comme un élément essentiel du contrat d'engagement. Troisièmement, quand il y a eu retrait ou diminution de traitement, les employeurs peuvent prétendre, dans certains cas, que le salaire constituait une forme de gratification plutôt qu'une partie intégrante du système de rémunération. Enfin, ils peuvent essayer de prouver que le nouveau régime de rémunération se voulait une simple proposition plutôt qu'une décision définitive.