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OUTSOURCING AND SUPPLY CHAINS IN CANADA

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Introduction

While data on the extent of outsourcing by Canadian businesses is scant, there is general agreement that over the last several decades the phenomenon has increased and taken a variety of forms including the use of global supply-chains (offshoring) and domestic subcontracting (outsourcing).¹⁷⁵ In this way, large businesses have been able to shed responsibility for the employees who actually perform the work. David Weil has aptly characterized this phenomenon as “fissuring”, which can take a variety of forms including sub-contracting, franchising, and other arrangements.¹⁷⁶ A related phenomenon that will be addressed here is the use of temporary employment agencies through which companies continue to produce goods and services internally but try to avoid responsibility for having their own employees by securing workers on ostensibly temporary bases through an agency’s action as intermediaries. Indeed, in both scenarios, there are intermediaries between leading businesses and the workers who perform the productive labour, which may result in poorer terms and conditions of employment because of the more highly competitive environment in which the work is performed and concomitantly in greater challenges for workers in gaining the benefit of protective labour and employment laws. Despite these well-known problems, Canadian labour and employment law has largely responded to these challenges in a piecemeal fashion.

¹⁷⁵ A study that examined outsourcing and offshoring between 1961 and 2003 found a large increase in the outsourcing of service inputs but a much more limited change in the outsourcing of material inputs. However, it also found a significant increase in the percentage of outsourced goods and services that were secured through offshoring. See John R. Baldwin and Wulong Gu (2008) “Outsourcing and Offshoring in Canada” (Statistics Canada, Economic Analysis Research Paper Series, 11F0027M, No. 055).

¹⁷⁶ David Weil (2014) *The Fissured Workplace* (Cambridge: Harvard University Press).

A prefatory note before proceeding: Canada is a federal state in which the provinces are given constitutional authority to legislate with regard to business and employment relations. Consequently, each province has its own laws governing these matters, although, the general situation of business freedom and limited worker protection is common across jurisdictions. Our focus here, therefore, is on Ontario, the Canadian province with the largest population and economy.

1. Is outsourcing a legal form of production organization?

Businesses are free to organize themselves as they see fit. This includes the freedom to outsource production, in whole or in part. Moreover, the law permits multiple forms of outsourcing. A company can sub-contract with another to provide any good or service it requires, which might include the production of a component or the provision of cleaning or food services. As well, it may choose to operate through franchise agreements rather than to own and operate outlets itself. The source of this freedom derives from freedom of contract and does not need positive legislative enactment. Indeed, quite the opposite. Restrictions on the freedom to outsource require positive state action and there has been very little appetite in Canada for imposing such restrictions.

2. Are there limits and/or prohibitions to outsourcing?

As previously noted, Canadian law does not prohibit or limit outsourcing. Moreover, as indicated below, when outsourcing occurs, companies can generally avoid legal responsibility for the employees of the companies with whom they sub-contract. However, Canadian law does patrol the boundary between ‘genuine’ outsourcing and other transactions that produce a different legal effect.

There are two key distinctions that arise in this context. The first is between sub-contracting and the sale of business. This distinction arises in a situation where a company formerly produced a good or service for itself but wishes to cease doing so. One option is to sell that part of its business as a going concern (sale of a business); another is to terminate the activity and to sub-contract for it. In either scenario, the employees from the selling or sub-contracting company may be hired by the purchasing company or the company to whom the work has been sub-contracted. The legal consequences that flow from the sale of a business were explored in greater detail in a previous Comparative Labour Law Dossier, IUSLabor 1/2015.

The second key distinction goes to the question of whether there has been a genuine arms-length sub-contracting or outsourcing or whether the company continues to

exercise control so that it continues to be responsible for the duties of the employer. Apart from the question of whether a transaction is *bona fide* or a sham, adjudicators will consider the question of the degree of control, if any, the user retains over the company with whom it has contracted. The most common scenario in which related-employer status will be found is where there is some common ownership and control between the two firms.

3. Does the company that partly or totally outsources its production have any labor or Social Security responsibility towards the subcontractor's workers? What responsibilities?

On the assumption that the company has genuinely outsourced all or part of its production, with one narrow exception, it has no responsibilities whatsoever to the subcontractor's employees. The narrow exception is in the area of occupational health and safety regulation, where the employees of the sub-contractor perform work on the sub-contracting company's premises. In Canada, employers are responsible to provide a reasonably healthy and safe working environment to all *workers* and so the fact that some workers may not have employment status does not relieve the employer who has control of the premises where work is being performed of responsibility for their health and safety. However, where an owner of lands on which a construction project is taking place hires a constructor, the constructor and not the owner is the party responsible for health and safety on the project.¹⁷⁷

4. And regarding pension plans and pension funds?

As in the previous answer, the sub-contracting company has no legal responsibility for the sub-contractor's employees, including pension plans and pension funds. If the sub-contractor defaults on its pension obligations, its employees cannot seek redress from the sub-contracting business.

5. Is the subcontractor legally obliged to recognize its workers the same labor conditions applicable to the workers of the user company?

Sub-contractors are not under any legal obligation to offer their workers the same conditions of employment enjoyed by workers at the user company. A sub-contractor is free to negotiate entirely new conditions of employment with its employees even if this results in significantly less compensation for the performance of the same work.

¹⁷⁷ *Occupational Health and Safety Act*, R.S.O. 1990, c. O.1.

6. In which cases is outsourcing considered fraudulent or there is an illegal transfer of workers? What are the consequences?

As mentioned previously, Canadian law patrols the boundary between “genuine” outsourcing and illegitimate attempts by employers to skirt their statutory employment obligations. While an employer is free to contract out a function of their business they no longer wish to operate they cannot escape their employment responsibilities through “creative” corporate restructuring.

If a user company retains a sufficient degree of control over a sub-contractor then the employees of the sub-contractor can apply to have the user company deemed a “*related employer*” under the *Employment Standards Act, 2000*.¹⁷⁸ (The “ESA”). If the claim is successful, then the sub-contractor and the user company will be treated as one employer for the purposes of imposing statutory employment obligations. The court looks to a number of factors to determine whether a sub-contractor is engaged in “*related or associated activities*”:

- Common management.
- Common financial control.
- Common ownership.
- Common trade name or logo.
- The movement of employees between two or more business entities, the use of the same premises or other assets by the entities or the transfer of assets between them.
- Common market or customers served by each business.¹⁷⁹

Canadian courts have been reluctant to use related employer provisions to regulate industries that rely heavily on sub-contracting practices such as the creation of supply chains. Despite the fact that the conditions of employment imposed by sub-contractors are often, in large part, determined by the contractual terms imposed by the user company, courts have refused to deem these kinds of business relationships as “*related or associated*”. As long as the user company maintains an arms-length relationship, in respect to management and ownership, towards its sub-contractors it is unlikely that the court will pierce the corporate veil and treat two legally distinct entities as one for the purposes of imposing the obligations of the employer.

¹⁷⁸ *ESA, 2000*, SO 2000, c 41, s 4.

¹⁷⁹ *Lian v Crew Group et al*, (2001), 54 O.R. (3d) 239, at para 47.

7. Is the hiring of workers through Temporary Employment Agencies allowed in your country? If so, in which cases?

In all provinces in Canada, it is legal to hire an employee through a temporary employment agency. In Ontario, the *ESA*, which sets minimum terms and conditions in areas such as wages, working time and termination and severance of employment, establishes an employment relationship between the temporary agency worker, known in the Act as the “assignment employee” and the temporary employment agency, known as a “temporary help agency.”¹⁸⁰ Through the establishment of this relationship, the *ESA* legitimizes the existence of temporary employment agencies as entities that provide employment services for a price or mark-up that is derived from paying assignment employees an amount that is lesser than the rate charged to client firms. User firms of assignment employees are clients of the agency. In Ontario, as elsewhere in Canada, there are no limitations on the duration of assignments or, for that matter, the length of time assignment employees may be engaged by an agency.

8. Are there specific cases or economic activities in which hiring workers through Temporary Employment Agencies is limited and/or prohibited?

Under the *ESA*, regulations governing temporary help agencies aim mainly to limit certain well-documented abusive practices on the part of agencies.¹⁸¹ For example, there are specific prohibitions on charging fees to assignment employees. An agency cannot charge a fee to an employee upon registering with an agency, for assigning the employee to a client firm or providing services to the employee such as resume and interview preparation.¹⁸² Agencies are also prohibited from barring assignment employees from becoming direct employees of client firms.¹⁸³ However, there is an exception to this general rule: if a client firm enters into direct employment with an assignment employee, the temporary help agency may levy “buyout” fees on the client firm during a period lasting six months from the day the assignment employee began work for the client firm as an agency employee.¹⁸⁴ This provision therefore sanctions formal restraints on the mobility of assignment employees in the labour market, and encourages temporary help agencies to cycle employees from one short assignment to another in order to retain the mark-up on their wages.¹⁸⁵ Other prohibitions include that a temporary help agency cannot prevent its client firms from providing a reference for

¹⁸⁰ *ESA*, 2000, s.74.3.

¹⁸¹ Leah F. Vosko (2010) "A New Approach to Regulating Temporary Agency Work in Ontario or Back to the Future?" *Relations Industrielles / Industrial Relations* 65(4): 632-653.

¹⁸² *ESA*, 2000 s. 74.8(1).

¹⁸³ *Ibid.*

¹⁸⁴ *ESA*, 2000 s. 74.8(2).

¹⁸⁵ Vosko, "A New Approach to Regulating Temporary Agency Work."

an assignment employee, and a client firm cannot penalize an employee for inquiring about, or exercising, their rights under the *ESA*¹⁸⁶; in other words, the Act contains anti-reprisal provisions acknowledging the vulnerability of workers engaged as assignment employees.

Certain kinds of written information must also be provided to the assignment employee; for instance, the temporary help agency's name and contact information,¹⁸⁷ and a copy of an information sheet outlining the minimum employment standards applicable to assignment employees, in the employees' first language if available.¹⁸⁸ Upon being offered a work assignment, an employee must receive certain written information about the client firm including the legal name of the entity, contact information, the rate of pay and benefits for the assignment, information on hours of work, a job description, the duration of the assignment if known, and the pay day/period.¹⁸⁹

9. What labor and Social Security liabilities do Temporary Employment Agencies have with respect to the workers hired and transferred to user firms? And the user firm?

As the employer of record, with regard to general labour and Social Security liabilities, the temporary help agency is responsible for fulfilling its obligation to assignment employees under the *ESA*, as well as for social insurance contributions mandatory in Canada (e.g., Employment Insurance premiums, Canada Pension Plan premiums etc.) and in Ontario (e.g., the temporary help agency is responsible for paying Workers' Safety and Insurance Board premiums even though it shares the responsibility for ensuring a safe work environment with the client firm).

However, in recognition of the complexity of the triangular employment relationship characterizing temporary agency work and responding, in particular, to the overrepresentation of *ESA* violations in the area of unpaid wages among groups encompassing assignment employees,¹⁹⁰ amendments to the *ESA*, in 2014, which came into effect in 2015, allow client firms to be held joint and severally liable for unpaid wages, overtime pay, and public holiday pay, in the event that temporary help agencies

¹⁸⁶ *ESA*, 2000 s.74.12 (1).

¹⁸⁷ *ESA*, 2000 s.74.5 (1).

¹⁸⁸ *ESA*, 2000 s.74.7 (1).

¹⁸⁹ *ESA*, 2000 s.74.6 (1).

¹⁹⁰ Leah F. Vosko, Andrea M. Noack, and Eric Tucker (2016) "Employment Standards Enforcement: A Scan of Employment Standards Complaints and Workplace Inspections and Their Resolution under the Employment Standards Act, 2000." Online: http://digitalcommons.osgoode.yorku.ca/all_papers/265/. Also, see also Ministry of Labour (2015) Temporary Help Agencies: Blitz Results. Online:

fail to pay monies owed to the employee.¹⁹¹ The extension of joint and several liability beyond wages, overtime and public holiday pay to cover all *ESA* violations is also currently under discussion as part of a government initiated Changing Workplace Review that is charged with investigating the dynamics underlying the magnitude of precarious employment in Ontario, and presenting options for fostering decent work.¹⁹²

Under the *Occupational Health and Safety Act*, both the temporary help agency and the client are jointly responsible for the duties of the employer, including the provision of training, instruction and information and of a safe work environment.

10. How are the labor conditions applicable to workers hired by Temporary Employment Agencies and transferred to user companies determined?

A general provision for equal treatment between assignment and direct employees is absent in the *ESA*.¹⁹³ Rather, the same minimum floor of employment standards applies to these groups; in other words, assignment employees are covered under the *ESA*'s general provisions related to minimum wages, hours of work, daily rest periods, time off between shifts, weekly/bi-weekly rest periods, eating periods, and overtime. Special rules, however, apply to assignment employees in the areas of public holiday pay,¹⁹⁴ termination of employment, and severance pay¹⁹⁵; these rules pertain to the calculation of entitlements in light of the often intermittent nature of temporary agency work.

11. Other relevant aspects and personal assessment of the regulation regarding outsourcing and supply chains

As a liberal market economy, Canada prioritizes freedom of contract over worker protection, including the freedom of businesses to organize themselves as they see fit. As a result, businesses have a relatively free hand to outsource and offshore as well as to secure employees through temporary help agencies. This freedom has serious consequences for workers, resulting in job loss, deteriorating terms and conditions of employment and difficulty enforcing the employment rights they continue to enjoy. The government response, considered here at a provincial level in Ontario, to these adverse effects is generally limited. For example, displaced workers may collect Employment

¹⁹¹ *ESA*, 2000 74.18 (1).

¹⁹² C. Michael Mitchell and John C. Murray (2016) "Changing Workplaces Review: Special Advisors' Interim Report." Online: https://www.labour.gov.on.ca/english/about/pdf/cwr_interim.pdf, p. 252.

¹⁹³ The Interim Report of the Changing Workplaces Review, *ibid*, poses, as a potential option for legislative reform, establishing equal wages for the same or similar work performed by assignment employees and direct employees of a client firm under certain circumstances.

¹⁹⁴ *ESA* 2000 s.74.10(1).

¹⁹⁵ *ESA* 2000 s. 71.11.

Insurance but only if they qualify, sham transactions are voided if detected, and the temporary help industry is weakly regulated.

References and judicial decisions

See footnotes.