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THE RIGHTS AND REMEDIES OF EMPLOYEES AGAINST INSOLVENT EMPLOYERS

MOIZ RAHMAN*

Résumé
Dans cet article, l’auteur étudie la récente décision de la Cour d’appel de l’Ontario dans la cause Ontario (Ministère du travail, Normes d’emploi) versus Rizzo & Rizzo Shoes Ltd. (fiduciaire de). Cette décision donne une interprétation du droit des employés à recevoir un avis de cessation d’emploi ou un salaire à la place d’un avis en vertu de la Loi sur les normes d’emploi, L.R.O., 1990, chap. E-14, articles 57 et 58. Dans cette décision, on maintient que les employés dont l’emploi a pris fin lorsque leur employeur a reçu une ordonnance de séquestre n’ont pas le droit de recevoir un avis de cessation d’emploi ou un salaire à la place d’un avis en vertu de la Loi sur les normes d’emploi. Cet article fait la critique de cette décision et suggère un certain nombre de stratégies pour la contourner.

Introduction
On March 10, 1995 in a unanimous decision the Ontario Court of Appeal dealt a further blow to employees who are unfortunate enough to lose their jobs because their employer goes bankrupt. In the case of Ontario (Ministry of Labour, Employment Standards) v. Rizzo & Rizzo Shoes Ltd. (Trustee of), the Court of Appeal decided that employees whose employment is terminated as a result of a receiving order being made against their employer are not entitled to termination pay or severance pay under Ontario’s Employment Standards Act. The Rizzo decision will have national implications for a number of reasons. It is the first ruling by a provincial appellate court on the issue, and most provinces have provisions similar to Ontario’s in their employment law schemes. Furthermore,

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2. R.S.O. 1980, c. 137 [hereinafter ESA ].

since the *Bankruptcy and Insolvency Act*\(^4\) is a federal Act, courts have indicated a desire to keep bankruptcy jurisprudence consistent across the country despite its adjudication at the provincial level.\(^5\) It is impossible to know exactly how many workers will be affected by this decision, but it would appear that it would be a significant number. In 1993 in Ontario there were 3,984 business bankruptcies, the majority of which occurred in the retail and service sector—\(^6\) that sector whose employees most often rely upon minimum standards legislation.

The decision will have a direct impact on the work of the Workers' Rights Group at Parkdale Community Legal Services (PCLS), as well as other poverty law clinics which handle such claims. The Workers' Rights Group at PCLS has represented employees in group claims against bankrupt employers in the past; notable cases include Perrin Industries, and Lark Manufacturing. PCLS is currently handling a group claim which illustrates the severity of the decision. The claim is on behalf of nine employees against a bankrupt employer (in the food service sector), a claim which includes claims for termination pay under the *ESA*. In the case of all but one of the employees the claim is for one week's termination pay plus 4% vacation pay—the equivalent of about $270 per employee.

In addition to this group claim, the Workers' Rights Group handles a number of individual claims against employers who are insolvent or otherwise financially unstable. It is also worth mentioning that the issue of bankrupt employers was considered so important that group expertise in Bankruptcy and Insolvency Law as it relates to casework and organizing was a goal of the Workers' Rights Group in 1991-92.\(^7\) Consequently, a large part of this paper will be devoted to considering strategies for getting around the decision, and possible law reform efforts to ensure that workers who suffer the misfortune of unemployment are not left without minimum statutory entitlements. A discussion of the *Rizzo* case will be followed by a critique of the Court of Appeal's decision, and a consideration of possible strategies to circumvent the decision.

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The Rights and Remedies of Employees Against Insolvent Employees

The Facts
On April 13, 1989 a receiving order was made against Rizzo and Rizzo Ltd., a company which operated a chain of retail shoe stores across Canada. On April 14, the Bank of Nova Scotia, a secured creditor, appointed a receiver to manage the property. The receiver employed a number of employees of the bankrupt company to assist in the liquidation of the bankrupt's assets. By July, the bankrupt's property had been liquidated and all of the stores closed. On August 23, the Ministry of Labour filed a proof of claim with the trustee in bankruptcy on behalf of 873 employees of the bankrupt company. The total claim, for termination, severance, and vacation pay totalled $2,600,122.93. The trustee disallowed the claims of the employees for termination, severance, and vacation pay on the grounds that "the bankruptcy of an employer does not constitute dismissal from employment."8

The Ministry of Labour appealed the trustee's decision to the Ontario Court (General Division) and was successful in having it reversed. Farley J. held that bankruptcy did constitute a termination of employment under the ESA, thereby triggering the termination and severance pay provisions of the Act. In his reasons, Farley J. argued, inter alia, that as remedial legislation, the ESA should receive a large and liberal interpretation to ensure that its object is attained9 (the reasons of Farley J. will be discussed in more detail below). The trustee appealed the General Division decision to the Ontario Court of Appeal.

The Decision of the Court of Appeal
The reasoning upon which the Court of Appeal's decision is based is quite simple. The court looked to the wording of the relevant sections of the ESA, and the past jurisprudence which interpreted those sections. The provisions of the ESA considered by the Court of Appeal were ss. 40 and 40a (now ss. 57 and 58 of R.S.O. 1990, c. E-14 respectively). Those sections read as follows:

40. (1) No employer shall terminate the employment of an employee who has been employed for three months or more unless he gives [appropriate period of notice].

40a. (1) Where,
(a) fifty or more employees have their employment terminated by an employer in a period of six months or less; and
(b) the terminations are caused by the permanent discontinuance of all or part of the business of the employer at an establishment,
the employer shall pay severance pay to each employee ...

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The court held that the wording of the termination and severance pay sections clearly indicate that "termination pay and severance pay are payable only when the employer terminates the employment."  

The court then considered past jurisprudence on the issue to determine whether or not a bankruptcy constitutes termination "by the employer." All but one of the decisions considered by the court supported their final conclusion that disentitled the employees to termination and severance pay. Two of the cases, *Re Malone Lynch Securities* 11 and *Re Kemp Products* 12 dealt with the same issue as *Rizzo* and both disallowed claims on the grounds that the termination and severance pay provisions of the ESA did not apply to bankrupt employers because the claimants' employment had not been terminated by their employer but by a receiving order. In *Kemp Products*, a distinction was drawn between bankruptcy at the instance of an employer's creditor, and a voluntary assignment in bankruptcy. The court implied that although termination pay was not owing in the former case, "it might be otherwise if the bankruptcy had resulted from an assignment in bankruptcy at the instance of the company." 13 The Court of Appeal in *Rizzo* chose not to comment on this distinction since the case before them did not involve a voluntary assignment. 14 The highest decision considered in *Rizzo*, *Mills-Hughes v. Raynor*, 15 dealt with a different issue; however, the court said in *obiter* that *Malone Lynch* was correctly decided, and that there was no entitlement to termination or severance pay upon bankruptcy. 16

Finally, the court considered at length the case of *Re Royal Dressed Meats* 17 whose reasoning runs contrary to the above-mentioned jurisprudence. Like *Mills-Hughes*, *Royal Dressed Meats* is not directly on point, and the Court of Appeal emphasized this fact in order to dismiss its contrary analysis as *obiter*. In *Royal Dressed Meats*, the obligation for termination and severance pay arose prior to bankruptcy, since the employees were terminated prior to and not as a

result of the bankruptcy. The court in *Rizzo* approved of this reasoning. However, in *Royal Dressed Meats*, Saunders J. took the liberty of discussing at length whether there would have been entitlement to termination and severance pay had the employees been terminated as a result of the bankruptcy. Interestingly, Saunders J. dismissed the remarks of the Court of Appeal in *Mills-Hughes* as *obiter* since the court in that case was not considering a claim in bankruptcy. Saunders J. concluded that based on a transitional provision placed in the *ESA* which specifically excluded its application to bankrupt employers, the Ontario legislature had intended for the provision dealing with severance pay to apply to employees who were terminated as a result of the bankruptcy. In dismissing this reasoning, Austin J.A. commented that "it is neither necessary nor appropriate here to determine the intention of the Legislature in enacting the provisional subsection." According to Austin J.A. "the intention of the legislature, as evidenced by the introductory words of ss. 40 and 40a ... was not altered in any way by the enactment of the provisional section." Thus, based on the past jurisprudence, and the clear wording of the *Act*, the court held that the issuance of a receiving order did not trigger the termination and severance pay provisions of the *ESA*.

Although the *Rizzo* decision appears to disentitle employees from claiming termination and severance pay from their bankrupt employers, it is not clear whether the decision puts an end to such claims entirely. The main question that remains unanswered is whether the termination and severance provisions are triggered when it is the employer who files an assignment in bankruptcy. Because the Court of Appeal chose to bring up this issue but not answer it, the issue remains unsettled. In fact by not answering the question after bringing it up, the court has created more confusion around the issue. On the one hand it could be argued that by adopting the holding of *Kemp Products*, the court in *Rizzo* gave tacit approval to the distinction made in *Kemp Products* between an involuntary and a voluntary bankruptcy. On the other hand, it is arguable that, since the court did not feel the need to address the issue and make a distinction, the result in the case of a voluntary assignment would be the same. Either way, by not clearly answering the very question which it raised, the court has left open an opportunity for claims to be made by employees in cases of voluntary assignments.

It is also not clear whether the decision should be narrowly construed so as to apply only to claims made under the *ESA*, or whether it would apply to claims for reasonable notice (termination pay) under the common law. The decision turns on the actual language of the *Act*. The court emphasized that it was the

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introductory words of the termination and severance pay provisions which disallowed the employees' claims. Thus, it is unclear whether an employee could file a proof of claim for termination pay arguing he or she is owed damages for breach of the employment contract. In a regular common law action for breach of contract an employer would only be relieved of the duty to pay such damages if it could argued that the employment contract was frustrated. However, based on the narrow application of the frustration doctrine, it is unlikely such a defence would succeed (the doctrine of frustration will be given detailed consideration below). In any case, since the Rizzo decision does not address this issue, it leaves this question unanswered as well.

The Rizzo decision also has the effect of shutting out employees from the government's Employee Wage Protection Program. Even though one of the purposes of the program is to compensate employees whose employers are insolvent or bankrupt, the decision will mean that employees are no longer entitled to receive compensation from the Program. Subsection 58.9 (1) of the ESA clearly states that an employee "may be compensated when wages are due and owing and the Program Administrator has verified that the wages are owing and their amount." Since employees of a bankrupt are no longer owed termination and severance pay, it follows that they are not entitled to benefit from the very program intended to protect them.

**CRITICISM**

The decision of the Court of Appeal in Rizzo is flawed in a number of ways. Not only did the court leave a number of the issues mentioned above unsettled, the court ignored a number of valid points raised in the General Division decision below, as well as ignoring fundamental (and common sense) principles of statutory interpretation.

The principal mistake made by the Court of Appeal in Rizzo was its decision to look to the statute rather than the common law for the definition of termination. Upon termination of an employment contract, an employee is entitled to damages for reasonable notice also known as termination pay. The ESA, being minimum standards legislation, has a section on termination pay in order to specify the minimum quantum of damages available. Thus, if one is able to successfully sue an employer for wrongful dismissal under the common law, one would be entitled to damages which are no less than the amount prescribed by the Act. There is no definition of termination in the statute. Section 57 of the...

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19. S. 58.4(1)(a) makes employees of insolvent employers eligible if they have filed a proof of claim, and that claim has not been paid.

Act is not intended to provide a definition of termination. There is another subsection, s. 57(10), which indicates those circumstances in which an individual would not be entitled to termination pay under s. 57. These grounds are essentially the same as those grounds which would exculpate an employer from liability for damages under the common law. It would seem only logical that the court should look to the broader principles of contract law rather than four words in the Act to determine whether or not there has been a termination.

Furthermore, since the ESA specifically states that it does not suspend any remedies available at common law, it follows that, being minimum standards legislation, one should at least have as many rights under the ESA as under the common law. Under the common law, there is clearly a breach of the employment contract (barring, of course the application of the doctrine of frustration to be discussed in detail below), and therefore entitlement to reasonable notice or damages. Therefore, the court’s strict interpretation of the words “terminated by the employer” leads to the absurd result of an employee having more rights under the common law than under the remedial legislation which is intended to rectify defects in and supplement the common law.

Aside from the court’s failure to look to the common law, and the absurd result flowing therefrom, the court ignored some basic principles of statutory interpretation when it considered those four important words—“terminated by the employer.” The reasons of Farley J. in the decision below illustrate the shortcoming of the appellate decision in the case.

The principal interpretive mistake made by the Court of Appeal was its failure to construe the provision according to the broader goal of the Act. As Farley J. said in the original judgment:

“[s]ince the object and intent of the ESA is to provide minimum employment standards to benefit and protect the interests of employees and is therefore remedial in nature, it should receive such far, large and liberal interpretation as is necessary to ensure that its object is attained according to its true meaning spirit and intent.”

Farley J. went on to point out that basing entitlement merely on the timing of termination would be “an arbitrary and unfair result that would defeat the intended working of the ESA.”

21. ESA, supra note 2 s. 6.


23. Ibid. at 451-2.
Farley J. also pointed to the transitional provision which the Court of Appeal dismissed as being unimportant. He reasoned that the transitional provision would not be necessary had it not been meant to apply to bankrupt employers, and that its existence would appear "to eliminate any question of the bankruptcy not being treated as something which affected the employment relationship." It is unclear why the Court of Appeal did not believe that this apparent manifestation of legislative intent was important.

The Court of Appeal also erred by its own interpretation of s. 40 and 40a of the ESA. The Court held that the bankruptcy was not a termination by the employer. However, even in the case of an involuntary bankruptcy, the bankrupt must do something—an act of bankruptcy—in order for a creditor to be able to successfully petition a court to issue a receiving order. A company or individual may be petitioned into bankruptcy by its creditors if it is insolvent, and commits one of ten acts listed as acts of bankruptcy under s. 42 of the Bankruptcy and Insolvency Act. An act of bankruptcy includes leaving the country or otherwise absenting oneself with intent to defeat one's creditors; a fraudulent conveyance under the Act; defaulting on a proposal made under the Act. In all cases, it is the bankrupt who commits an act. Although an act of bankruptcy may not be the desire of the bankrupt, and may be avoided at all costs, it is nevertheless an act by the bankrupt. Indeed, in an unrelated case (to be discussed further below) the Ontario High Court held that the carrying on of one's business affairs so as to necessitate the appointment of a receiver was intentional enough to invoke the actively worded successor employer provision of the Labour Relations Act. Thus, it would be open to a court to interpret any of these acts, rather than the piece of paper that is the receiving order, as supplying the necessary volition on the part of the employer to trigger both the termination and severance pay provisions of the ESA.

One of the biggest problems with the Rizzo decision is linked to this aspect of volition and the active nature of dismissal insisted upon by the courts to trigger the ESA. The court, by refusing to address the question brought up by Kemp Products, has left this area of the law unsettled. In the absence of any direction

24. Ibid. at 453.
25. Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 s.43(1) [hereinafter Bankruptcy Act]. Note that an insolvent person is defined in s. 2 of the Act.
26. Ibid. subsection 42(1)(d).
27. Ibid. paragraph 42(1)(b).
28. Ibid. paragraph 42(1)(i)
29. Infra, note 65.
by the court, the only statement on this issue is that in *Kemp Products*, as well as some *obiter* from an Alberta Court of Queen’s Bench case which mentioned in passing that such a distinction is arbitrary and that a bankruptcy should mean no entitlement regardless of who initiates it. The Court of Appeal, however, gave no opinion regarding the direction it would lean on the issue. Ironically this sloppy decision making on the part of the court may actually end up helping claimant employees in a future case since the court has left this opening in the law. It is open to employees whose employer has initiated bankruptcy to file proofs of claim and litigate the issue. In fact, the group termination claim now being handled by Parkdale involves such a voluntary assignment by the employer. For now at least, the Ministry of Labour seems to be drawing a distinction and views a voluntary assignment as being favourable to employees.

**STRATEGIES TO AVOID RIZZO**

Although the *Rizzo* case will remain the law in Ontario with respect to entitlement to termination and severance pay, there are a number of strategies that claimants can adopt to get around its strict interpretation of the law. Some of the strategies involve construing the judgment as narrowly as it construes the *ESA*. Others operate within the broad interpretation of the decision in an attempt to creatively work within the constraints imposed by the Court of Appeal. For the purposes of my discussion, I will divide the discussion into claims made under the *ESA*, the language of which the decision hinged upon, and claims under the common law, based on the assumption that the decision, being an interpretation of the *ESA*, does not apply to the common law. Because there is a good chance that Parkdale Community Legal Services will represent clients of a bankrupt employer in the future, it is important to consider strategies to get around the decision, since judicial and legislative change are neither certain nor swift. Even if Parkdale does not act in another case involving a bankrupt employer, a number of these strategies should prove useful in the group claim which the clinic is currently handling.

**Claims Under the Employment Standards Act**

Perhaps the best strategy to get around *Rizzo* is to take advantage of the opening left by the Court of Appeal regarding the issue of who initiated the bankruptcy. As mentioned above, by not addressing the issue, the court left open the possibility that a distinction should be made between the claims. It could be


31. This information is based on the communication that the student caseworker in charge of the claim has had with the Ministry. Thus it is not clear that this is the official position of the Ministry.
argued that because the court followed the holding of *Kemp Products* (and did not reject the *obiter* from that case which raised this issue) it tacitly gave approval to the reasoning contained therein. However, some *obiter* from an old Ontario Supreme Court case, or lack of comment by the Court of Appeal on its own does not lend much support for the proposition. It is, therefore, important to present a strong persuasive argument in favour of the proposition. Thus, it could be argued that unlike the issuance of a receiving order, a voluntary assignment in bankruptcy is clearly an active, volitional act of an employer allowing it to fall within the termination and severance pay provisions. Furthermore, the employer is aware ahead of time that the employment relationship will terminate as a result of the voluntary assignment. Also, because it is the employer who initiates the bankruptcy, it would be open for the employer to terminate the employees prior to filing the assignment. The unfairness of the situation elucidated by Farley J. is even more evident when an employer would be able to make a simple choice which would give its employees access to termination and severance pay. The employer would have nothing to lose by doing so especially if it does not have enough assets to satisfy the claims. The employees would be able to collect from the Employee Wage Protection Program.32 As mentioned above, based on Parkdale’s communication with the Ministry of Labour regarding the group claim, it seems the Employment Practices Branch is sympathetic to this approach.33

Another approach is to operate within the judgment. Rather than concentrating on the type of bankruptcy, a claimant may have more chance of success if he or she tries to argue that he or she was terminated before the bankruptcy rather than by the bankruptcy. Companies on the verge of bankruptcy are often quite financially unstable prior to actually being declared bankrupt. They may go into receivership (to be discussed below), or they may continue to operate by barely making payments or somehow stalling creditors from taking over. When a company is financially unstable, the company will make sure that the creditors who will receive their due first will be the secured creditors—the ones who have the legal power to take over the business if the company defaults. It is the unsecured creditors who lack the leverage of the secured creditors who will be paid last. Of the unsecured creditors, it is the employees who are likely to remain unpaid. Indeed, in the group claim now being handled by Parkdale, this is precisely the case.34 The employees went without pay for approximately one

32. This would probably happen in most cases anyway given the low priority assigned to termination and severance pay in the settling of the bankrupt’s estate; they are unsecured, unpreferred claims.
34. It was the case in past cases handled by the clinic as well: Lark Manufacturing and Perrin Industries.
month prior to the assignment in bankruptcy of their employer. In such cases, employees may be successful in arguing that the non-payment of wages by their employer amounted to a fundamental breach of their employment contract thus constituting constructive dismissal from their employment. As a result they would be entitled to termination pay since their employment was effectively terminated prior to the bankruptcy of their employer.

An employee can claim that he or she has been constructively dismissed from employment when the employer unilaterally changes a fundamental term of the employment contract, and the employee chooses to treat this change as dismissal. Since payment of wages and the timing of such payment is a fundamental term of an employment contract it is not surprising that non-payment of wages has been held to be a breach of contract giving rise to constructive dismissal. Clearly the longer an employee is not paid, the more chance of succeeding with such an argument. One missed pay period may not be sufficient, although a court may be inclined to decide so where the employee is otherwise going to be denied termination pay because of Rizzo's emphasis on the timing of termination. The only thing that may foil a contention of constructive dismissal is the possibility that, by staying on after the unilateral change of employment, the employee may be deemed to have condoned the change.

Generally, an employee must leave and not accept the change if an argument of constructive dismissal is to succeed. If an employee stays on, it will be assumed that she has accepted the change and there will be a new contract which included the unilateral change. However, in such a case there are two ways to defend against a charge of condonation. Firstly, an employee cannot condone a change that she has no knowledge of. Thus, if the employee is promised that she will eventually see a paycheque, she cannot be deemed to have condoned total non-payment. Secondly, even if the employee offers no protest, it could be argued that, by staying on in employment, she was mitigating her damages. That is to say, she was staying on hoping to be paid instead of treating the non-payment as termination and leaving for the unemployment line. This mitigation argument is likely to succeed given the strong duty to mitigate imposed by courts in these tough economic times.

The foregoing strategies suffer from the same problem. Both are contingent upon the existence of a circumstance beyond the control of the claimant. If an

36. Ibid.
37. Mole, supra, note 35 at 3.105.
employer faithfully pays employees up to the date of a creditor initiated bankruptcy, the above arguments would not be successful. Thus, it is important to have other strategies ready in case the proper conditions do not exist. Alternatives are also useful since there is no certainty that the arguments would succeed even if the circumstances existed.

Claims Under the Common Law
A better strategy may be to avoid the ruling altogether by claiming termination pay under the common law as pay in lieu of notice (contractual damages). It is important to state at the outset that a claim under the common law can only be for termination pay and not severance pay. Severance pay has no common law equivalent and was intended to supplement regular termination pay in certain circumstances. Although one cannot be certain that the Rizzo decision might not also equally apply to a breach of contract under the common law, there are some strong arguments against its application to a claim under the common law. The most obvious is that the decision centres on the language of the ESA. The court gave no consideration to the question of whether a bankruptcy causes a unilateral repudiation of the employment contract. In fact, two of the cases cited by the court in Rizzo implicitly support the proposition that such a claim would be successful. Indeed, under contract law, an individual need not commit such a wilful and deliberate act as that required by the Rizzo decision to be held liable for breach of contract. The only thing that can save a promisor is the doctrine of frustration. As will be discussed below, the doctrine of frustration will probably not apply to bankruptcy.

In order to use the doctrine of frustration as a defence to an action for breach of contract, it is necessary to prove that the frustrating event must be unforeseen, or have occurred through no fault of either party. Also, a party cannot argue frustration if the party induced the frustration itself. Courts are loath to apply the frustration doctrine even in cases where contracts contain specific force majeure clauses meant to exempt the promisor from bearing the risk of non-performance. In the case of bankruptcy, the event is neither unforeseen, nor is it not the fault of the employer.

There is authority from the United States Supreme Court as far back as 1916 which held that bankruptcy does not serve to frustrate a contract. In the case of Chicago Auditorium Association v. Central Trust Company of Illinois, the U.S. Supreme Court held that bankruptcy "whether voluntary or involuntary ... [is]
the equivalent of an anticipatory breach [of the contract] (emphasis added)."

The most important part of the judgment for our purposes is the reasoning used by the court to arrive at this conclusion. The court said:

In short, it must be an implied term of every contract that the promisor will not permit himself through insolvency or acts of bankruptcy, to be disabled from making performance; and in this view, bankruptcy proceedings are but the natural and legal consequence of something done or omitted to be done by the bankrupt in violation of his engagement.\footnote{42}

This reasoning not only operates against the application of the frustration doctrine, it supports the theory that bankruptcy is the fault of the employer, and an act of the employer.

There is no Canadian jurisprudence on the issue of bankruptcy and the doctrine of frustration. However, there is \textit{obiter} from a judgment of the Supreme Court of Canada which would support the American view of this issue. In the case of \textit{Barrette v. Crabtree Estate},\footnote{43} the Supreme Court considered the rationale for a provision of the \textit{Canada Business Corporation Act}\footnote{44} which held directors personally liable for wages of employees. The court quoted several authorities, among them a 1904 case from Quebec whose reasoning echoes that of \textit{Chicago Auditorium}. The case said the following regarding directors’ personal liability:

\begin{quote}
The directors have personally this knowledge or should have it, and if, aware of the company’s embarrassed affairs, and specially of the danger of the speedy collapse and insolvency, they continue to utilize the services of employees who have no means of securing this knowledge and who give their time and labour upon their sole reliance, often, on the good faith and respectability of the company’s directors, it is not inequitable that such directors should be personally liable, within reasonable limits, for arrears of wages, thus given to their service.\footnote{45}
\end{quote}

Since the application of the frustration doctrine is based on the policy of appropriate risk allocation, it only seems logical to place the risk of non-performance on the company. Since employers are in a much better position than the employees to bear such risk, it would seem illogical to apply the frustration doctrine in the case of bankruptcy.

\footnotesize{\begin{itemize}
\item \footnote{41}\textit{Ibid.} at 415.
\item \footnote{42}\textit{Ibid.}
\item \footnote{43}1993, 101 D.L.R.(4th) 66 (S.C.C.) [hereinafter \textit{Barrette}].
\item \footnote{44}R.S.C. 1985, c. C-44, s. 119(1).
\item \footnote{45}\textit{Fee v. Turner} (1904), 13 Que. K.B. 435 cited in \textit{Barrette}, supra, note 43 at 76.
\end{itemize}}
Furthermore, two cases which the Court of Appeal used as authorities to deny the employees in *Rizzo* entitlement under the *ESA* support the possibility of a common law claim. In *Kemp Products*, the court considered a claim for a severance allowance under what the applicant argued was a contract. Unfortunately for the applicant, the contract contained the same language as the *ESA* with respect to entitlement for the allowance. The court held that there was no contract, and alternatively that if there was a contract the wording included therein meant there was no entitlement upon bankruptcy. However, the court held that if its conclusion was wrong and there was indeed a contract and its language did not disallow the allowance, the applicant would have been entitled to the allowance. In other words, the contract would not have been frustrated and there would be entitlement to an allowance under it.

In *Malone Lynch*, the court, in denying the claimant entitlement to termination and severance pay under the *ESA* said the following:

> In the present case, apart from the provisions of the *Employment Standards Act*, there is no right to damages for termination of employment. The claimant was employed by the trustee for a considerable period of time immediately upon the bankruptcy occurring so that he suffered no damages by reason of insolvency (emphasis added).

The implication of this statement is that had the claimant suffered damages—had he not been employed after termination—he would have been able to recover damages for wrongful dismissal. Both *Kemp Products* and *Malone Lynch* seem to reinforce the contention that there is no frustration upon bankruptcy, and that there is a right to claim damages for breach of contract.

**More Radical Strategies**

Since there is never any certainty that an employee will be able to recover from a bankrupt estate, it is important to have alternative strategies aside from filing proofs of claim. Furthermore, there is no guarantee that the Employee Wage Protection Program will exist in the future. Because the money for the program comes from consolidated revenue, there is no guarantee that it will not be subject to the same cuts that other equally important social compensation systems are being subject to.

**Lifting the Corporate Veil**

A much more radical solution than those mentioned above involves asking courts to lift the corporate veil and allow employees the right to hold directors


of the corporate employer personally liable. There are two possible ways of making directors personally liable for termination pay. The first is to use the more conventional action of lifting the corporate veil in accordance with accepted common law principles. The second, more drastic, solution is to go after the directors for committing the tort of negligence. Both solutions, particularly the latter, are not likely to succeed since they are quite radical. However, there is support for both strategies in the common law thereby making them candidates for consideration.

Courts detest looking behind the corporate entity, even when it may be quite logical to do so. Ever since the pronouncement of separate corporate identity in the landmark case of Salomon v. A. Salomon & Co.,48 the directing minds of companies have been able to retreat behind the corporate veil to avoid personal liability. There is no authoritative case law on when it is appropriate to lift the corporate veil. The issue was considered by the Supreme Court of Canada in Kosmopoulos v. Constitution Life Assurance Co.49 In Kosmopoulos, Wilson J. held that the court would lift the corporate veil in cases where it would “yield a result too flagrantly opposed to justice, convenience or the interests of Revenue”50 and that “if the veil is to be lifted at all that should only be done in the interests of third parties who would otherwise suffer as a result of that choice.”51 Employees are certainly third parties, and the Supreme Court itself in Barrette has endorsed some compelling reasons why it is in the interests of justice to lift the corporate veil. However, since the Supreme Court decided in Barrette that the provision of the CBCA 52 which made directors personally liable for wages did not make them liable for termination pay, it is important to first consider whether the existence of these statutory provisions may act as a bar to recovering from directors under the common law.

The Supreme Court decided in Barrette that employees do not have the right to recover termination or severance pay from directors personally under s. 119(1) CBCA. In denying entitlement to the employees, the court held that the words

50. Ibid. at 214.
51. Ibid.
52. Subsection 119(1) reads as follows:

Directors of a corporation are jointly and severally liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.
"debs ... for services performed for the corporation" in s. 119(1) did not encompass termination or severance pay since such amounts are damages for breach of contract and not for "services performed." The court was hesitant to extend personal liability further where it was not the explicit intent of Parliament to do so. The question that arises next is whether the provision of the statute, and the strict judicial interpretation given to the statute, precludes employees from attempting to hold directors liable for owed termination pay under the common law. The short answer is no. There is nothing in the language of the section that would preclude further liability on the part of directors under the common law. The section only says that directors are liable; it does not say that directors are personally liable only for debts for services performed. Further, the Barrette decision should not prejudice a common law action since, like Rizzo, it is based on the precise wording of the statute.

Indeed, the obiter from Barrette goes a long way in buttressing the case for director liability for termination pay under the common law. As mentioned above in the discussion of the frustration doctrine, the Supreme Court seems to have endorsed the rationale behind holding directors personally liable for one type of debt under the CBCA. The entire decision turned on the wording of the provision. If the existence of the provision does not bar a common law action, the obiter from Barrette could go a long way in convincing a court that lifting the corporate veil would serve the interests of justice. Aside from the obiter discussed earlier in this paper, there is yet another authority which may provide compelling reasons to lift the corporate veil. In Barrette, the court quoted the following from now Justice Iacobucci's book:

[lifting the veil] can be justified on the grounds that directors who authorize or acquiesce in the continued employment of workers when the corporation is not in a position to pay them should not be able to shift the loss onto the shoulders of the employees. Other creditors who supply goods and services to the failing corporation are not entitled to this kind of preference, but neither are they as dependent on the corporation as employees, nor as vulnerable.

This reasoning, added to the fact that employees have been barred from collecting elsewhere (if other strategies prove unsuccessful, or where the assets of the company could not satisfy the money owed to the employees) might help convince a court that it is in the interests of justice to lift the corporate veil.

53. Barrette, supra, note 43 at 81.
54. Ibid.
A more novel approach towards lifting the corporate veil may come in the way of an action against the directors for negligence. There is authority from the Ontario Court of Appeal to support the proposition that directors of corporations owe a duty of care to employees. In the case *Berger v. Willowdale A.M.C.* the court held that an action for negligence did lie against the director of the company even where the employee was barred by the *Workers Compensation Act* from proceeding against the corporate employer. Cory J.A. held that there was no reason why the duty of care of the corporate employer and the duty of care owed by the director to the employee could not co-exist. Cory J.A. stressed the personal knowledge of the director over the situation which gave rise to the cause of action. If one combines the aforementioned reasoning from *Barrette* with the holding from *Berger* it would appear that an employee would be entitled to claim damages in negligence in the case of bankruptcy of their employer. Such an action might actually be strengthened by the *Rizzo* decision particularly if the directors of the company know that if they do not terminate their employees prior to the bankruptcy they will not be entitled to have a claim against the estate.

**Receivership**

Bankruptcy is not the only cause for concern for an employee. An equally problematic situation may occur for employees when their employer is forced into receivership. Although technically a business could go on functioning after a receiver recovers whatever was owed by the business, in reality once a receiver takes over, the business will probably never exist again. In the event of receivership, employees may have a remedy not available against a bankrupt employer. There is the possibility that an employee may be able to hold the receiver personally liable for termination and severance pay under the successor employer provisions of the *ESA*. Sub-section 13(2) of the *ESA* states:

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57. Ibid. at 98.
58. Ibid.
60. Personal liability in such a case means that the receiver would use money acquired from a sale of the assets of the business or from profits made from the operation of the business. The money is considered the costs of its administration of the business which is satisfied prior to paying secured and unsecured creditors.
Where an employer sells a business to a purchaser who employs an employee of the employer, the employment of the employee shall not be terminated by the sale, and the period of employment of the employee with the employer shall be deemed to have been employment with the purchaser for the purposes of Parts VII, VIII, XI, and XIV.\(^{62}\)

Subsection 13(1) indicates that the term "sells" "includes leases, transfers, or disposes of in any other manner." Although bankruptcy trustees have been held not to be successor employers,\(^{63}\) there is case law that supports the proposition that receivers are successor employers. However, the ability of employees to collect under this provision will depend a great deal on the type of receiver which takes over the business, and on what the receiver does after taking control of the business. A brief explanation of the law of receiverships will be followed by a survey of the case law regarding employees' rights in the event of receivership.

There are two types of receivers, privately appointed, and court-appointed. If a business defaults on payments to its secured creditor, the secured creditor may appoint a receiver pursuant to the terms of the security instrument, or the creditor may sue the business for the debt and ask the court to appoint a receiver to preserve the assets of the business pending a judgment. The distinction between the two types of receivers is important, since each type of receiver acts in a different capacity. The privately appointed receiver is an agent of the secured creditor, while the court appointed receiver is an officer of the court and is "a principal with respect to employees and contractual obligations of the debtor."\(^{64}\) No court or tribunal has held a privately appointed receiver to be a successor employer, since such receivers act only to collect the debt owed to the creditor which appointed them.

It is important to mention at the outset that the decisions which have held receivers to be successor employers have been based on the successor employer provisions of provincial Labour Relations Acts rather than Employment Standards legislation. However, based on the language of the ESA—which is almost identical to that of the Ontario Labour Relations Act \(^{65}\)—and the reasoning of

\(^{62}\) Ibid.

\(^{63}\) Re Rizzo Shoes Ltd. (August 15, 1990), (Ont. S.C.) [unreported]. This case arose out of the same bankruptcy as the one which is the subject of this paper.

\(^{64}\) Bennett, supra, note 59 at 458.

\(^{65}\) R.S.O. 1990, c. L.2, s. 64. Subsection 64(1) says the following:

"sells" includes leases, transfers and any other manner of disposition.

"successor employer" means an employer to whom the predecessor employer sells the business.
the judgments, there is no reason why the decisions would not support such a finding under the ESA as well.

The first such decision was that of the B.C. Labour Relations Board in *Uncle Ben's Industries Ltd. v. Canadian Union of United Brewery, Flour, Soft Drink and Distillery Workers* [66] where the Board held that the appointment of a receiver by a court was a disposition under the provisions of the B.C. *Labour Relations Act*. [67] The Board did, however, draw a distinction between a receiver which merely liquidated the assets of the debtor, and one who carried on the business of the debtor; the Board held that only in the latter case would the receiver incur liability. [68] The decision in *Uncle Ben's* was approved by the Ontario High Court in *Maritime Life Assurance Co. v. Chateau Gardens (Hanover) Inc.* [69] where the court held the receiver liable for an arbitration award which took place prior to the appointment of the receiver. The court held that the appointment of a court-appointed receiver fell within the definition of a disposition under the Ontario *Labour Relations Act* (OLRA). Interestingly the court held so even though, in the opinion of the court, the words of the B.C. Act upon which the *Uncle Ben's* decision was made were passive, while the words of the Ontario Act were active: the B.C Act requires the business to be “sold, leased ... or otherwise disposed of,” while the Ontario Act’s provisions are triggered only “where an employer ... sells,” [70] The court found that the Ontario Act, even with its active voice, was meant to “cover the situation where an employer who has conducted his business in such a way that a court has appointed a receiver ... may be held to have ‘disposed’ of it for the purposes of the Act.” [71] The court held that by virtue of the sale, the receiver was “bound by the collective agreement as if it had been a party thereto,” and was liable to pay the arbitration award “as part of its administration from the proceeds of the sale” prior to the claims of the secured and unsecured creditors. [72] The court drew no distinction between what the receiver did with the business, but the reasoning upon which

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67. Whyte, supra, note 66 at 33.

68. Ibid.


70. Maritime Life, supra, note 69 at 758.

71. Ibid. at 758-9.

72. Ibid.
it based its judgment would appear to make it applicable regardless of what a receiver did after taking over the business.

Given the court's reasoning in *Maritime Life*, it would be open to a court to give the same interpretation to the *ESA*, since the language is nearly identical to that of the *OLRA*. Thus, if a court followed the above reasoning, it might be possible to exact payment of owed termination and severance pay from the receiver-manager. Furthermore, the *ratio* in *Maritime Life* appears to be broad enough to apply to a receiver regardless of what the receiver does after taking over the business. Nevertheless, application of the section would appear to be more certain where the receiver actually does carry on the business and effectively becomes an employer by keeping on employees to help it realize the owed debt.

**CONCLUSION: LAW REFORM**

The simplest solution to the problems caused by *Rizzo* is to amend the *ESA* to cover employees who are terminated as a result of bankruptcy. Such an amendment would be as simple as adding a subsection stating that "for the purposes of section 57 and 58, a termination by the issuance of a receiving order, or by a voluntary assignment in bankruptcy shall be a termination by the employer." Given the apparent worry in the Ministry over this decision, it is not unlikely that such an amendment will happen. Even if the termination and severance pay provisions are not altered in such a way, it might be as effective to alter the provisions Part XIV.1 dealing with the Employee Wage Protection Program to extend entitlement to employees who are barred from collecting from the estate of the bankrupt because of *Rizzo*. In the interests of fairness, altering the definition of termination would seem to be the wiser alternative. Since the money for the Employee Wage Protection Program is paid out of the government's consolidated revenue fund, it would make more sense to first allow employees to attempt to collect from the estate which owes them rather than from the taxpayers of the province. It seems unfair to allow an employer to socialize liability when it may have the means to satisfy claims.

Simply making employees statutorily entitled to termination and severance pay will not ensure that they will receive these amounts. Claims for termination and severance pay are unpreferred, unsecured claims. The low priority which they are afforded means, in many cases, that the entitlements are not satisfied from the bankrupt's estate before it is soaked dry by the higher priority creditors. Since it seems unfair to allow employers to socialize liability for these entitlements, it may make more sense to ensure employees receive these amounts from the bankrupt's estate or from the owners' (directors') pockets.
In order to ensure that employees receive termination and severance pay before other creditors, changes must be made at the Federal level. Originally, the province could deem an entitlement to be held in trust for an employee. Since trusts do not form part of the bankrupt’s estate, the beneficiary of the trust effectively gets payment prior to other creditors. The ESA deems vacation pay to be held in trust for employees whether or not it is treated this way by the employer. Unfortunately, the Supreme Court of Canada has held that statutorily deemed trusts are not valid trusts for the purposes of the Bankruptcy Act. Aside from a statutorily deemed trust, there is no other way the province has of altering the priority of creditors in the event of bankruptcy. Thus, a change must be made to the Bankruptcy Act itself in order to give employees’ claims for termination and severance pay some type of priority. This can be accomplished in one of two ways, depending on the amount of priority which Parliament wishes to assign them. Since employees already have preferred, unsecured claims for wages, Parliament may deem wages under this section to include amounts for termination and severance pay. The other option is for Parliament to recognize provincially deemed trusts in the Bankruptcy Act for wages (which would include termination and severance pay) just as it recognizes such trusts for tax and some pension contribution purposes. Of the two options, the former seems like the more likely option since it does not vary the existing priority structure. However, since it still leaves the claims behind those of secured creditors, it does not do very much to guarantee that the claims will be satisfied by the bankrupt’s estate.

A more drastic (and therefore unlikely) solution would be to impose personal liability upon directors to satisfy the claims. Although it would most certainly be unpopular with the business community, the most effective solution would be to make directors personally liable for termination and severance pay just as they are so liable for wages. The harshness of such personal liability could be tempered by imposing a ceiling on the amount of liability as exists for director liability for wages.

Another helpful legislative reform would be a clarification of the successor employer provisions of the ESA to indicate whether receivers who carry on a business are bound by successor employer provisions of the ESA. If receivers were deemed to be successor employers it certainly puts employees in a superior position vis a vis other creditors since it would mean that employees would be

73. Bankruptcy and Insolvency Act, supra, note 25 s. 67.
74. ESA, supra, note 2 s. 15.
able to receive their entitlements prior to other creditors. Although such a provision may seem to help employees, it is not without its problems. If a receiver fears that it may be liable for large termination and severance pay obligations, it may choose not to continue the business and simply close the business without the help of any previous employees. Since successor employer provisions would probably not apply to a receiver who merely takes over and liquidates the assets of a business, it might be less costly for a receiver not to run the business if it meant incurring liability for termination and severance pay. Regardless of what the legislature chooses to do, some kind of change should be made in order to have some certainty on the issue.

Given the Court of Appeal's refusal to adopt a purposive interpretation of the ESA, it is the job of the legislature to ensure that the termination and severance pay provisions are changed so it is certain that they apply to bankrupt employers. Until such a legislative change is made, it is important that employee advocates try to use all possible strategies to circumvent the harshness of the Rizzo decision. The strategies most likely to succeed would appear to be claims under the common law for wrongful dismissal damages, or claims under the ESA in the case of a voluntary assignment in bankruptcy by the employer. Ultimately, the Rizzo decision illustrates the relationship that exists between employment law and insolvency law. It is therefore important that workers' advocates know of the implications of insolvency on employees' claims as well as the all of the remedies available to satisfy these claims, particularly considering the number of bankruptcies which occur in this province in each year, and the vulnerability of employees in the event of bankruptcy.

76. Whyte, supra, note 66 at 44.