

on

Insolvency Law

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FRASER MILNER CASGRAIN LLP

EMPLOYEE SEVERANCE CLAIM COMPROMISED IN THE CCAA

In *West Bay SonShip Yachts Ltd. v. Gerald Esau*, the British Columbia Court of Appeal dealt with an employee's claim for wrongful dismissal under the Companies' Creditor Arrangement Act.

Mr. Esau was an employee of West Bay from 1991 until 2006. On December 16, 2005, West Bay made an application for protection under the CCAA. On January 17, 2006 Mr. Esau was given notice of the termination of his position as Vice President of Production effective June 6, 2006.

An application was brought regarding Mr. Esau's wrongful dismissal claim under the plan. The Supreme Court chambers judge ordered that Mr. Esau was a contingent liability at the filing date, and as such fell within the definition of "claim". She further found that Mr. Esau's claim was a "pre-filing claim" and was compromised by the plan. The order significantly affected Mr. Esau because as a creditor subject to the plan, he was required to file a proof of claim. Mr. Esau had not filed a proof of claim. The order permanently stayed the action of Mr. Esau and did not grant an extension of time for Mr. Esau to file a proof of claim. As a result, Mr. Esau would not recover any claim under the plan of arrangement.

Mr. Esau appealed this order, and two issues were considered by the Court of Appeal.

1. Is a wrongful dismissal claim a contingent liability prior to the termination of employment? and
2. Is an employment contract an executory contract?

Regarding the contingent liability of a wrongful dismissal claim, Madam Justice Levine, citing *Re Sitter*, drew a distinction between statutory and common law claims. The Court outlined the cases which found a statutory claim was a contingent liability did not apply to the facts of this case.

In determining whether a wrongful dismissal claim was contingent, Madam Justice Levine reviewed the definitions of a contingent liability in the common law. After her review, she concluded the following:

21 The question that arises in this case is whether the existence of a contractual obligation, and the corresponding potential for a claim for damages for its breach, is a contingent liability of the party who may commit the breach. I conclude that, although there is the potential of a claim for damages, there can be no liability, contingent or otherwise, where there is no present cause of action. That is, until there is a breach of contract, there is no legal basis for any claim or any corresponding liability.

...

24 I conclude that the liability to pay damages if an employment contract is breached for failing to give reasonable notice of termination is not a contingent liability within the ordinary meaning of that term. Until the termination of employment without adequate notice, there is no injury. The possibility of a breach of contract is not sufficient to give rise to a contingent liability.

25 Therefore, Mr. Esau's wrongful dismissal claim did not accrue from the outset of his employment and it did not represent a contingent liability of West Bay at the Filing Date. Consequently, Mr. Esau's claim is not a pre-filing claim on this basis.

Turning to the second issue, whether the employment contract was executory, Madam Justice Levine outlined that if Mr. Esau's claim was an executory contract at the Filing Date, then his claim for damages would become a claim as of the date of termination. Justice Levine reviewed the recent decisions on executory contracts and found Mr. Esau's employment contract was an executory contract.

30 The Alberta Court of Appeal recently considered the meaning of “executory contract” in *Kary Investment Corp. v. Tremblay*, 2005 ABCA 273 at para. 19, 371 A.R. 339:

A contract is said to be executory if anything remains to be done under it by any party, and executed when it has been wholly performed by all parties: Halsbury’s Laws of England, 4th ed. reissue, vol. 9(1) (London: Butterworths, 1998) at 341, para. 606; *S. W. Mackay & Associates Ltd. v. Park Lane Ventures Ltd.* (1997), 32 B.C.L.R. (3d) 338 at para. 8 (S.C.). [Emphasis added]

31 In “A Joint Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals - Joint Task Force on Business Insolvency Law Reform - March 15, 2002”, the authors cited the following meanings for “executory contract”:

What is an executory contract? Neither the CCAA nor the BIA use the expression, but the United States Bankruptcy Code does in s. 365 (“Code, s. 365”). In general contract law, “executory contract” means a contract under which one or both parties still have obligations to perform. However, in U.S. bankruptcy law the expression is normally given a narrower meaning. According to the most widely accepted definition in the United States, an executory contract for the purposes of Code s. 365 is:

a contract under which both the obligations of the bankrupt [“A”] under the contract and the other party to the contract [“B”] are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

(Countryman, “Executory Contracts in Bankruptcy” (1974) 57 *Minnesota Law Review* 439 (Part 1), at 460).

32 The authors included an employment contract as an executory contract in this sense. See also: *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies’ Creditors Arrangement Act*, a Report of the Standing Senate Committee on Banking, Trade and Commerce, November 2003, at 131, and Janis Sarra, *Rescue!: The Companies’ Creditors Arrangement Act* (Toronto: Carswell, 2007) at 177-178, where employment contracts were characterized as executory contracts in the context of the discussion of insolvency laws. Professor Sarra noted (at 178-179) that damage claims resulting from termination or repudiation of executory contracts after the initial order are unsecured claims for damages.

33 None of these sources discussed the application of the U.S. definition of executory contract for bankruptcy purposes to an employment contract. It is not clear to me, because of the nature of the employment relationship, that that definition will generally apply. As a matter of contract law, if the employee fails to provide the promised services, or the employer fails to pay for services rendered, subject to any other terms of the contract, that would ordinarily be a material breach excusing the performance of the other party. Whether that conclusion would ordinarily apply to an employment contract is, however, a question I do not need to decide for the purposes of this case. The ordinary legal definition of executory contract covers these circumstances.

34 An ongoing employment contract, under which an employee has promised to render services in return for the employer’s promise to pay for those services, is an executory contract as there are obligations on both parties that are yet to be completed. Thus, Mr. Esau’s employment contract was, at the Filing Date, an executory contract.

35 Accordingly, Mr. Esau’s claim against West Bay for damages for wrongful dismissal fell within the definition of “Claim” in the Plan.

Madam Justice Levine rationalized her finding that Mr. Esau’s rights be compromised under the act as being consistent with the CCAA. The Court found that the plan permitted West Bay to rationalize its business affairs with a view to a reorganization that would make it viable in the future. Justice Levine cited *Skeena Cellulose Inc. v. Clear Creek Contracting Ltd.*, 2003 BCCA 344, (sub nom. *Skeena Cellulose Inc. (Re)*) 13 B.C.L.R. (4th) 236 in support of her findings.

In *Skeena*, the Court upheld the trial judge’s decision that terminated employees were not to be placed in a better position than other creditors (at para. 22), and noted that “[i]n the exercise of their ‘broad discretion’ under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights” (at para. 37). In

considering whether the arrangement under the CCAA, as a whole, was “fair, reasonable and equitable”, the Court noted that “equity” is not necessarily “equality” and that the courts looks to all of the creditors to see if rights are compromised in an attempt to balance interests (at para. 59). The Court concluded (at para. 60):

Finally, Madam Justice Levine deferred to the decision of the Chambers Judge and upheld the decision that Mr. Esau would not be granted an extension to file a proof of claim. The Court found that this would not be equitable and would result in prejudice which could not reasonably be alleviated.

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