



HAS THE BUSINESS CASE FOR EMPLOYMENT PRACTICES LIABILITY INSURANCE BEEN UNDERMINED BY THE EFFECT OF THE *HONDA V. KEAYS* DECISION?

By Valerie Dixon

Until very recently, the extent to which courts were willing to punish an employer for bad behaviour in the course of termination of an employee was relatively unknown. The spectre of significant punitive damages has led some employers to purchase employment practices liability ("EPL") insurance coverage, designed to provide protection against damages arising out of an employer's wrongful acts such as sexual harassment, discrimination and wrongful dismissal. However, the Supreme Court of Canada's recent decision in *Honda Canada Inc. v. Keays*, 2008 SCC 39, which significantly reduced the lower courts' damage awards, may have a chilling effect on the popularity and necessity of this type of insurance.



Employment Practices Liability Insurance: The Basics

While there is no standard EPL policy wording, the basic purpose of this kind of insurance is to provide an employer with coverage for "wrongful acts" performed in the employment context, including wrongful dismissal (actual or constructive), breaches of human rights legislation such as discrimination and harassment, defamation, infliction of mental distress and retaliatory treatment. It should be noted that the practicality of EPL insurance covering claims for wrongful dismissal (i.e. where a breach of the employer's implied obligation to provide reasonable notice of termination is alleged) has been questioned and as a result, some EPL policies have explicit exclusions for such claims.

EPL policies are usually "claims made" policies, meaning that coverage will depend on the employer receiving a claim and reporting it to the insurer within the time specified in the policy. Unless the claim is received within that time period, there will be no coverage. Thus, an employer would have to maintain its coverage for at least the amount of time in which an employee could bring legal action against the employer (in most cases, under BC's *Limitation Act*, 6 years) - which in many cases, is long after the employment has been terminated.

Insureds under EPL policies typically include both the corporate employer and its directors, officers and employees. Also, even where employees are not explicitly

covered under the policy, there may still be de facto coverage as a result of the vicarious liability of an employer for the acts of its employees (who participated in the wrongful conduct towards the claimant).

Lastly, in Canada, unlike the U.S., some EPL policies provide coverage for both compensatory and punitive damages. This makes sense in light of the fact that many of the acts (such as harassment) which are expressly covered under EPL policies, are those which may attract punitive damages.

The Facts in *Honda v. Keays*

Kevin Keays started out with Honda as an employee working on an assembly line, later moving to data entry. Eleven years later, he was diagnosed with chronic fatigue syndrome and ceased work. He received disability benefits from an independent insurer until those benefits were terminated as a result of the insurer's conclusion that Mr. Keays was able to return to work. Upon his return to Honda, Mr. Keays was placed in Honda's disability program which allowed him to take absences from work so long as it was related to his disability. However, Mr. Keays's absences began to exceed that which were supported by his doctor's notes. His doctor's explanations for his absences also "changed in tone". Honda became suspicious. Honda arranged for Mr. Keays to meet with an independent physician hired by Honda to investigate the reason for Mr. Keays's absences. Mr. Keays was subsequently asked by Honda to meet with an occupational medicine specialist to determine how Mr. Keays's disability could be accommodated. Mr. Keays then retained a lawyer because he was worried that his employment was going to be terminated. His lawyer sent Honda a letter outlining his concerns and offered to work towards a resolution. Honda did not reply.

Two members of Honda's management, including Mr. Keays's direct supervisor, met with Mr. Keays to explain their concerns about the doctors' notes he had produced in support of his absences. Mr. Keays was asked yet again to meet with the occupational specialist. Mr. Keays agreed to meet with the occupational specialist but subsequently refused on the advice of his counsel. He requested that Honda confirm the purpose, methodology and parameters of the consultation. Mr. Keays was then absent from work for a week. Upon his return, he was given a letter from Honda which stated, among other things, that Mr. Keays would be terminated if he refused to meet with the occupational specialist. The information requested by Mr. Keays as to the nature of the consultation was not provided and so Mr. Keays remained unwilling to meet with the specialist. As a result, Honda terminated Mr. Keays's employment.

The Trial and Appeal Decisions in *Honda v. Keays*

The trial judge found that Mr. Keays had been wrongfully dismissed and held that he was entitled to damages in lieu of reasonable notice of 15 months. The judge also extended the length of notice to 24 months as a result of the manner in which the termination had taken place (such damages commonly being referred to as "Wallace

damages" awarded for bad faith by an employer). Finally, the judge awarded Mr. Keays \$500,000 in punitive damages. This was based on the trial judge's finding of "egregious bad faith displayed by Honda in the manner of the termination and the medical consequences flowing therefrom".

The Ontario Court of Appeal dismissed Honda's appeal and found that, given Honda's conduct, an award of punitive damages was reasonable, however, that Court did reduce the sum of punitive damages from \$500,000 to \$100,000 because it found that the trial judge's award was not proportional to the wrong that had actually been perpetrated.

The Supreme Court of Canada's Decision in *Honda v. Keays*

The Supreme Court of Canada (the "SCC"), however, disagreed with both of the lower Courts. First, the court commented on the scope and applicability of so called "Wallace damages". The court found that Honda's conduct when it terminated Mr. Keays did not constitute bad faith, and therefore no Wallace damages were payable. Specifically, the SCC held that the type of conduct which would attract such damages (attacking the employee's reputation at the time of dismissal, misrepresentation regarding the reason for termination, dismissal meant to deprive the employee of a benefit or other right, etc.) was simply not present. Of particular note was the SCC's confirmation that Wallace damages should only be awarded if the employer's conduct directly caused a loss to the employee. Thus the appropriate focus, therefore, is on the compensation required to address the loss directly flowing from the employer's actions. The calculation of Wallace damages does not focus on the degree of wrong of the employer.

Second, the SCC held that a clear distinction must be drawn between damages for conduct in the matter of dismissal (Wallace damages) which are meant to be compensatory, and punitive damages which are meant to punish wilful wrongful acts which are malicious and outrageous. The SCC found that Honda had not engaged in behaviour that should attract punitive damages because its conduct had not been harsh, vindictive, reprehensible or malicious. This was not an "exceptional case" in which punitive damages was appropriate.

Thus the lower courts' awards of Wallace damages and punitive damages were set aside by the SCC, leaving Mr. Keays with only damages for wrongful dismissal. The decision will also make it more difficult in future, for all former employees to successfully make claims for damages for bad faith in the manner of dismissal (Wallace damages), or for punitive damages.

The Effect of the Supreme Court's Decision in *Honda v. Keays* on the Necessity of EPL Insurance

Many supporters of EPL insurance relied on the large amount of damages awarded against Honda in the trial and appeal decisions in the Keays case, to make the

argument that a prudent risk management plan justified such coverage. However, the SCC has significantly undercut that line of reasoning. It would seem that only in the most extreme and rare circumstances will damages result to an extent that insurance coverage is necessary.

EPL insurance may still be relevant and necessary for certain organizations, such as non-profit societies, which do not have assets or resources to defend employment practices claims or satisfy judgments for related damages. The average employer, however, may simply not have the exposure to warrant the expense of this type of insurance.

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