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ARE LAYOFFS THE RIGHT RESPONSE TO COVID-19?

Businesses across Ontario are struggling as the effects of COVID-19 become ever more acute. Governments have ordered certain businesses to close and still more are shutting down as a result of the sharp economic decline. In response, many employers have begun widespread and potentially long-lasting layoffs. While layoffs can be a prudent business decision in many cases, they may expose employers to significant liabilities. Even temporary layoffs can be considered a constructive dismissal, triggering severance entitlements. As a result, there are a number of steps that should be taken before employers choose to lay off employees.

Even the most well-planned layoffs will likely attract litigation. Employers should prepare accordingly. Luckily, the steps that can be taken to avoid layoffs will also position employers well to defend those decisions later on. In this article, we discuss the basics of how layoffs work; why they may constitute constructive dismissal; and how the legal doctrine of frustration of contract could serve as a defence to constructive dismissal, especially if employers make the right choices before or during layoffs.

The law of layoffs and frustration of contract

The *Employment Standards Act, 2000* ("*ESA*") provides an employer with the ability to temporarily lay off its employees at any time and for any reason, assuming the reason is not discriminatory or otherwise illegal. These provisions provide the mechanics of a layoff, but do not address whether an employer has a right to lay off employees. Under the *ESA,* employers can temporarily lay off employees without having to provide statutory notice of termination or, in some cases, severance pay. Under the *ESA*, a temporary layoff does not trigger the termination of an employee's employment, if, among other things, the employee is only laid off for 13 or fewer weeks out of a 20-week period. Employers do not necessarily have to continue benefits during a temporary layoff, but doing so could extend the period of the temporary layoff to last longer than 13 weeks without triggering a termination under the *ESA*.

However, employers must also consider the common law, which operates separately from the *ESA*. The *ESA* merely provides for the minimum standards with which employers are required to comply. Generally, under the common law, an employer cannot unilaterally change the fundamental terms of the employment relationship, for example by reducing hours or wages. This includes temporarily laying off an employee. If an employer unilaterally changes a fundamental term, an employee may consider the employment relationship to be at an end and claim constructive dismissal. If constructive dismissal is established, the employee is entitled to common law reasonable notice or pay in lieu of reasonable notice in the same way as if the employee was terminated.

This common law principle in the context of temporary layoffs can be ousted by the parties if the employment agreement specifically gives the employer the right to temporarily lay the employee off, or if layoffs are a well-known occurrence in the workplace. For example, in certain industries temporary layoffs may be quite common. Yet many employers do not include such a term in an employment contract; do not have written employment contracts; and do not typically lay off employees.

There may, however, be two defences available to employers facing constructive dismissal claims in the face of the COVID-19 pandemic.

The first potential defence for employers is to argue that the term allowing for temporary layoffs during a global pandemic is *implied* in the contract. It is possible that an employer could persuade a court that, even though the parties did not specifically include a term about temporary layoffs, this is an implied term in light of the pandemic and is in the best interests of the employees who were laid off. Given the current emphasis on social distancing and the government ordering the shut down of businesses in response to COVID-19, courts may be sympathetic to this argument. Employers would also have to engage in a graduated recall of employees to avoid the consequences of a deemed termination in the circumstances.

The courts are generally quite wary when they are asked to imply terms into a contract on behalf of parties. Doing so requires the court to infer or speculate about the intentions of the parties when they formed the contract. This has been viewed as contrary to core contractual principles. Nevertheless, courts have been more open to reading in implied terms in the employment law context.

There are added nuances that are unique to the employment relationship. Implying a term giving an employer the right to lay off employees temporarily would deprive vulnerable employees of their rights – at least temporarily – to receive severance payments in the middle of a global pandemic. This is especially true in the employment context, where contracts are often interpreted in favour of employees.

"Frustration" is the second and potentially more viable defence for employers facing claims for constructive dismissal following temporary layoffs. The doctrine of frustration of contract allows a party to a contract to take the position that the contract is at an end when an intervening, unforeseeable event occurs that is beyond the control of either party. This event makes the continued performance of the contract impossible, or a matter entirely different than the parties intended. Frustration does not occur where the supervening event and impossibility were foreseeable or self-induced by one of the parties. In this way, frustration does not require the court to imply a term into the contract. A frustrated contract is rather deemed to have come to an end with no further obligations by either party because it has become impossible to perform.

A temporary layoff because of COVID-19 is not <u>necessarily</u> frustration of contract

In employment law, frustration usually occurs when an intervening event renders a central term of the employment relationship fundamentally different from what the parties originally contemplated. The clearest cases of this are where the employer's business is physically

destroyed by an intervening event, or where the employee dies, is incarcerated, or has an illness or disability proven by medical evidence to be permanent.

Given the current state of the law, it is far from clear that frustration will be applied to temporary layoffs simply because they were caused by COVID-19. In the context of layoffs during COVID-19, the specifics of each case will matter greatly in answering the key question of "impossibility". Central to that process will be explaining the reasons for, and characteristics of, the layoffs at issue. Courts will examine every decision an employer made before it decided to lay off its employees. In addition, there will be arguments about whether the "impossibility" was temporary or permanent.

Business closures because of the government's emergency orders may lead to frustration

The Ontario government's recent orders to shut down businesses may increase the likelihood of a finding of frustration. By complying with the government's order, many businesses are being forced to temporarily lay off employees. This order arguably creates a "supervening illegality" which makes it impossible for businesses to carry out their contractual obligations pursuant to the original terms of the contract. If the contract cannot be performed on those terms, then it is not the bargain the parties agreed to and the contract is frustrated. As with frustration more generally, the change in law creating the impossibility must be one the parties did not foresee and did not provide for in the contract. Further, the illegality of contractual performance created by the change in the law must not be temporary or trifling when viewed in the context of the contract as a whole.

On March 17, 2020, the Ontario government declared a provincial state of emergency under the *Emergency Management and Civil Protection Act* ("EMCPA"). On March 23, 2020, the government issued new orders that all non-essential businesses were required to close for at least 14 days as of midnight on March 24. While orders to close shops under the EMCPA are not statutes passed by the legislature, they are orders in council made pursuant to statute that could result in penalties, including incarceration and/or fines for individuals of up to $100,000, for directors and officers of up to $500,000, and for corporations of up $10,000,000. It is therefore arguable that the government's EMCPA orders to close down certain businesses have created a "supervening illegality" for the continued performance of certain employment contracts during the coronavirus pandemic.

A likely issue with this argument is the duration of the orders. At this time, the orders are temporary. It is unclear if temporary closures of this kind, even if they are "laws", would constitute a supervening illegality and meet the high bar set by the doctrine of frustration. It may be that courts interpret "permanent" more broadly in the context of this cascading event that takes place over the coming months.

Economic hardship in and of itself does not lead to frustration

Economic hardship in and of itself is rarely a sufficient reason to invoke frustration in the employment context. The court's reasoning on this issue is rooted in the belief that employers have broad discretion when responding to a financial crisis. This assumes that businesses have a

broad range of options available to them during an economic downturn beyond simply temporarily laying off employees. That element of choice means the supposed impossibility of performance is self-induced, which in turn means the doctrine of frustration does not apply.

Courts have found, for example, that impossibility of performance cannot be alleged where performance of the employment contract is merely more onerous or less profitable than the parties had hoped it would be. Courts have similarly held that frustration does not apply to situations where an employer chooses to sell, dissolve, or otherwise voluntarily terminate its business. Indeed, the court in at least one case found that severance obligations survived an employer's voluntary declaration of bankruptcy.

In these unprecedented times, with the government ordering the closure of businesses, it is unclear whether these principles would apply in the same way.

Though every case depends on its own facts, it is apparent that employers who may find themselves litigating wrongful dismissal claims will need to think carefully about how they lay off their employees. The groundwork of a successful defence will have to begin now, before or as layoffs are happening. Employers will need to make business decisions that make layoffs as much of a last resort as possible. Evidence of those decisions will also be important. Given the number of initiatives being launched to assist Canadians during the pandemic, courts are likely to scrutinize an employer's pre-layoff business efforts even more.

Proactive Steps for Employers

In summary, absent a contract stating otherwise, temporary layoffs have historically exposed employers to liability for constructive dismissal. The best defence to such claims is likely the doctrine of frustration. Relying on that doctrine, however, is not easy, even in the best of cases. As a result, employers need to make business decisions now to establish the right groundwork to defend themselves later. The key to this is seeking out as many reasonable alternatives as possible to maintain payroll and operations before initiating temporary layoffs.

In this respect, we have summarized a number of private and public resources available to employers in our COVID-19 Bulletin, which can be found **here**.