Some legal issues to consider when reducing or eliminating benefit coverage for active employees

In a rising cost environment, employers may contemplate containing expenses by reducing or eliminating the benefit coverage they provide to employees. There are, however, legal considerations that can affect an employer's ability to make such changes.

In this article, we look at an employer's ability to make unilateral changes to benefit coverage for active employees as well as the potential impact of a recent court case.

Contractual guarantees and promises

In a unionized environment, the employer's ability to make changes to benefit coverage is typically governed by the terms of the collective agreement. For that reason, the focus of this article is the non-union environment.

In a non-union environment, the employer needs to be concerned with whether a proposed change might breach the terms of its employment contracts with employees.

When an employer unilaterally reduces salaries or reduces or eliminates other forms of compensation, there is a risk that an employee will view the action as a fundamental breach of the employment contract – equivalent to firing the employee. This could lead to an employee claim for damages against the employer on the grounds of "constructive dismissal."

Whether an employee has grounds for a successful claim depends on the particular facts. The Supreme Court of Canada, in a leading 1997 case *Farber v. Royal Trust*, said that to reach a conclusion that an

employee has grounds for a successful claim depends on the particular facts. The Supreme Court of Canada, in a leading 1997 case *Farber v. Royal Trust*, said that to reach a conclusion that an employee has been constructively dismissed, "*the judge must ask whether, at the time the offer was made, a reasonable person in the same situation as the employee would have felt that the essential terms of the employment contract were being substantially changed.*"

For example, an employee who has major prescription drug expenses may be more affected by a reduction or elimination in drug coverage than an employee with only an occasional drug expense, and may be more likely to consider drug coverage an essential term of employment.

Whether a particular employment contract guaranteed benefit coverage at a certain level or whether the employer made promises in other communication materials could also determine whether a change affects an essential term of employment.

What can employers do?

An employer who wants to unilaterally reduce or eliminate benefit coverage may want to consider these points to help reduce the number of complaints and challenges:

1. Expressly reserve the right to change benefit coverage in employment contracts and in employee communication materials.

Employers may wish to expressly reserve the right to reduce or eliminate benefit coverage for any reason in a written contract of employment with new employees.

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Provide any other legislated or negotiated severance benefits; and

• If the employer still wishes the employee's services, offer to rehire the employee on the new

As well, an employer with a benefit plan to which employees contribute may want to make clear in employment contracts and employee materials that employee contributions may increase if the cost of the plan increases.

2. Ensure that any decision to reduce or eliminate benefit coverage is legitimate and well-reasoned.

Employers contemplating a change should ensure that it is a well-reasoned business decision. A court may consider economic pressures as one factor among many in determining whether a change is a fundamental breach of an employment contract.

For example, the Alberta Court of Appeal, in the 1994 case *Hamilton & Olsen Surveys Ltd. v. Otto*, in which employees' vacations were reduced and employer contributions to an RRSP eliminated, said that, "*reductions in the benefit package due to external economic pressures, but where salaries are maintained, have consistently escaped characterization as fundamental breaches*."

However, that case involved only a small reduction in overall compensation. It is open for a court to find, in the facts of a case, that an elimination or reduction in compensation is a fundamental breach of the contract, despite economic pressures.

For instance, the British Columbia Court of Appeal, in the 1988 case *Farquhar v. Butler Brothers Supplies Ltd.*, in which an employee's salary was reduced by 30 per cent and fringe benefits eliminated, said that, "*neither adverse economic circumstances generally nor the poor financial position of the employer should affect the damages to which a wrongfully dismissed employee is entitled*."

3. Consider "grandfathering" benefit coverage levels for current employees.

To help reduce the number of complaints or challenges from current employees, an employer may consider "grandfathering" coverage levels. The reduction or elimination would then apply only to new employees, under a new employment contract.

4.Give employees reasonable notice of any change.

Some employers take the view that since they can terminate employment by giving reasonable notice, they can also change the terms of employment, including benefit coverage, by giving reasonable notice.

What constitutes reasonable notice depends on the particular facts. The nature of the proposed change, the length of the employee's service, along with good business and employee relations practices, will guide employers in this regard.

If a proposed change is major, the employer may want to refer to the notice periods required for terminating employment as a guide. It is important to note that the notice period for terminating employment is different for each employee, depending on the employee's situation. As well, there are both "statutory notice periods" and "common law terms of employment.and "common law notice periods" when terminating employment.

5. Take steps if an employee rejects the proposed reduction or elimination.

A recent case from the Ontario Court of Appeal suggests that simply giving reasonable notice may not be sufficient.

When a change is made to an essential term of employment, the employer also needs to make clear to employees the consequences of not accepting the change, and respond accordingly if any employees reject the change.

If an employee rejects the change, the March 2008 case, *Wronko v. Western Inventory Service Ltd.* (discussed below), suggests that an employer needs to:

• Formally terminate the employment;

• Provide the employee notice of termination or pay in lieu of notice;

• Provide any other legislated or negotiated severance benefits; and

• If the employer still wishes the employee's services, offer to rehire the employee on the new terms of employment.

• If these steps are not taken, the employee may be entitled to rely on the original terms of employment.

Review the situation with legal counsel

These are just a few of the legal considerations for employers contemplating changes to benefit coverage.

There may also be statutory restrictions. For example, an employer who provides health or disability coverage can not eliminate prescription drug coverage for Quebec employees and dependants nor reduce it below the level required by statute.

Each employer's situation is different. It is important for employers considering a reduction or elimination of benefit coverage to review the situation with legal counsel.

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Case of interest – Wronko

In *Wronko v. Western Inventory Service Ltd.*, an employee entered into an employment contract that included a severance clause. The December 2000 contract promised the employee two years' salary on termination of employment.

In September 2002, the company gave the employee a revised employment contract stating that he would receive only 30 weeks' salary upon termination instead of two years' salary.

The employee rejected this new contract as a "significant reduction in [his] severance package." The company then gave the employee two years' notice that his employment contract would be changed at the end of the period to reflect the new terms.

At the end of the notice period, the company told the employee that the new terms were in force and stated: "*If you do not wish to accept the new terms and conditions of employment as outlined, then we do not have a job for you.*" The employee considered this to be a termination, stopped going to work and initiated court action based on wrongful dismissal.

The trial judge ruled that the company had the right to vary the severance clause by giving reasonable notice to the employee and that the two years' notice given was reasonable. However, the Court of Appeal for Ontario reversed the decision and ruled in favour of the employee.

The crux of the matter was the fact that the employee rejected the terms of the new contract when it was first presented to him in 2002. The Court of Appeal said the company had two choices at that point:

The company could have terminated the employment relationship and offered re-employment on the new terms. (This would have triggered the original severance provision at that time, requiring the company to pay two years' salary.)

Alternatively, the company could have accepted that there was no new contract and maintained the original contract.

Since the company did not terminate the employee's employment when he rejected the change in 2002, the court concluded that the company had accepted that there was no new contract. So when the company terminated the employee in 2004, the employee was entitled to two years' salary, in line with the original contract.

The *Wronko* case is relevant to Ontario employment situations, but may be of interest to employers across the country. Courts in other jurisdictions may consider the reasoning in *Wronko* when deciding cases.