

# **The Value of Treating Employees Fairly During Bankruptcy Protection**

Recently Severed Canadian Nortel Employees (RSCNE) Group  
February 17, 2009

## 1. Abstract/Background

The Companies' Creditors Arrangement Act (CCAA) is a Federal Act in Canada that allows financially troubled companies to restructure their financial affairs in order to avoid bankruptcy. There is a risk that companies can fall into the trap of focusing exclusively on financial issues and put at significant risk the overall health of the restructured company, thereby making the whole restructuring effort moot.

During the current recessionary times of 2008-2009, many companies have sought to leverage CCAA, which is impacting an increasing number of citizens. Bankruptcies are also on the rise<sup>1</sup> in virtually all sectors of Canada and employee treatment in these instances has been a subject of some concern. As a result, governments have been modernizing the law to ensure that employees are more fairly treated both during CCAA and in bankruptcy situations, as employees are deemed to have a special relationship with their employers. Still, several common practices associated with treating unsecured creditors' claims during bankruptcy protection that originated during the last century are obsolete, and need to be modernized.

This paper explores the impact of employee relations on a company during bankruptcy-related activities, and it highlights the constructive modernization of labour laws, reinforcing that the fair and ethical treatment of employees is of benefit to all stakeholders.

## 2. What is in the Best Interest of A Company?

In today's Knowledge Era-based economy, talent is a strategic differentiator and employees are a company's most important asset. A recent (Feb 2009) report from the Martin Prosperity Institute<sup>2</sup> reinforces the criticality of knowledge workers in the new Creative economy, especially during times of financial and economic crisis. The report emphasizes that "There is no greater resource than the creativity, innovativeness, and productive talents of our people." This has been recognized by companies as they compete to get the best and brightest from universities.

During times of economic and financial crisis, companies often turn to layoffs, but, contrary to popular belief, layoffs have been found to not only have negative

---

<sup>1</sup> [Office of the Superintendent of Bankruptcy Canada - Insolvency Statistics in Canada — October 2008](#)

<sup>2</sup> [Ontario in the Creative Age | Martin Prosperity Institute](#)

impacts on ex-employees<sup>3</sup> but also on layoff survivors<sup>4</sup> -- those still employed within the company who must continue to work to help the company succeed. How the survivors continue to perform and their perception of the company during the lay-off period and well into recovery efforts is, in large part, determined by how their ex-colleagues are treated when they are let go from the company.

Survivor research all points to fair treatment being in the best interests of a company. As noted in the *Academy of Management Journal*:

*“Procedural justice, job insecurity, and uncertainty all influence survivors’ reactions to layoffs (Brockner & Wiesenfeld, 1993). Survivors react more positively to layoffs when they believe that the layoffs were necessary, that fair decision criteria were used to select victims, and that victims were fairly treated and adequately provided for after the layoffs (Brockner, DeWitt, Grover, & Reed, 1990; Brockner, Grover, Reed, DeWitt, & O’Malley, 1987; Brockner, Grover, Reed, & DeWitt, 1992; Brockner, Tyler, & Cooper-Schneider, 1992; Brockner, Wiesenfeld, Reed, Grover, & Martin, 1993). Survivors exhibit higher work effort at moderate levels of job insecurity than at low and high levels of job insecurity (Brockner, Grover, Reed, & DeWitt, 1992). Finally, the uncertainty and turmoil following a layoff stimulates survivors’ “sense-making” behavior and makes them more susceptible to social cues in their environments (Brockner et al., 1997)... Survivors are more sensitive to issues of procedural justice and more susceptible to social cues when they have a psychological attachment to victims or perceive victims as similar to themselves (Brockner, 1990; Brockner et al., 1987).”<sup>5</sup>*

Severance payments are one aspect of “fair treatment” that fosters a positive perception of employment practices<sup>6</sup> and enables a company to maintain a positive relationship with both current and former employees. The concept of severance has evolved significantly<sup>7</sup> from when it was purely compensation to employees who lost their jobs. Severance today is recognized as a contract between the company and the ex-employee that results in many positive benefits. Severance enables a company to:

- Maintain a positive relationship with the ex-employee (which is important because severed employees often return to the company when conditions

---

<sup>3</sup> [The impact of layoff announcements on shareholders. | Labor & Employment > Human Resources & Personnel Management from AllBusiness.com](#)

<sup>4</sup> [Scientific Commons: THE EFFECTS OF DOWNSIZING ON SURVIVORS: A META-ANALYSIS \(2000\), 2000-05-01 \[West, Gladys B.\]](#)

<sup>5</sup> [NETWORK DESTRUCTION: THE STRUCTURAL IMPLICATIONS OF DOWNSIZING. \(01-FEB-00\) Academy of Management Journal](#)

<sup>6</sup> [Severance-CA](#)

<sup>7</sup> <http://www.ottawabusinessjournal.com/321138389829048.php>

improve because they know that they will be treated fairly, and with dignity and respect)

- Reaffirm non-compete agreements and ensure the protection of confidential information<sup>8</sup>
- Protect the reputation of the company as an employer, so that it can continue to attract new talent critical to future success
- Encourage employees to continue to speak positively about the company, which significantly helps with the morale of remaining employees<sup>9</sup> and prevents the significant damage that disgruntled ex-employees can cause; and
- Help ensure that former employees who become customers, suppliers or regulators behave favourably towards their former employer in future business situations.

A very recent (Jan 2009) example of such company behaviour is Smurfit-Stone, a ~\$7.5B Canadian company which filed for CCAA protection and chose to continue to pay severance post filing<sup>10</sup> as a core part of its restructuring plan.

During times of stress within a corporation, there is a real risk to a company if it breaks the trust it has with employees. In the recent case of Kadar Holdings<sup>11</sup> in the fall of 2008, shortchanging employees on severance incited riots and caused damage to company property. Company workers also chose to remain at home vs coming in to work. Bad employee relations often result in striking, which is detrimental to both employees and companies, which has been shown in one study<sup>12</sup>, to reduce shareholder value by 4% (\$7.2B).

Severance is good for all concerned, and as such has been standard practice for good companies for some time. For example, Nortel has reduced its workforce by more than 60% over the past 9 years, yet ex-employees have remained loyal to the company, promoting and defending it, and recommending Nortel products to customers. Many ex-employees have been rehired to fill critical skilled positions, largely due to the reputation Nortel had secured as a fair and equitable employer. The recent CCAA filing by Nortel has suspended the reasonable practice of honoring severance agreements and has resulted in mobilizing its former (and some current) employees, to challenge the company. This has had significant negative impact on the morale of remaining employees, who are no longer able to focus exclusively on the success of the company as before, and require significant increase in management attention at a time when an external focus is paramount.

---

<sup>8</sup> [http://www.ballmanfirm.com/Severance\\_Agreements\\_employers.shtml](http://www.ballmanfirm.com/Severance_Agreements_employers.shtml)

<sup>9</sup> [Severance Agreements Employers article Donna M. Ballman, P.A. Attorneys Ft. Lauderdale Florida](#)

<sup>10</sup> <http://www.smurfit.com:8080/files/FAQforCanadianRetirees.pdf>

<sup>11</sup> [Boing Boing: International: November 2008 Archives](#)

<sup>12</sup> [The impact of layoff announcements on shareholders. | Labor & Employment > Human Resources & Personnel Management from AllBusiness.com](#)

In times of financial difficulty, companies must continue to recognize that for any hope of successfully emerging from CCAA protection, their people - critical assets - must be part of the solution. The company will need a motivated and dedicated workforce. These assets, the knowledge workers that drive the economy, are in fact the most important factor affecting a re-emerging company's success, and they need to be treated with the highest priority both by the company and, in the event of bankruptcy, by the courts as well.

### **3. Society Clearly Demands Fair Treatment of its People**

People, through their government representatives, have set a priority to change obsolete employment laws to reflect fair and equitable treatment of employees. In Canada, there has been ongoing efforts to modernize the Canadian Labour Code<sup>13</sup> and steps have been taken to provide employees with Super-Priority in the event of bankruptcy<sup>14</sup>. These measures have consistently focused on increasing the fair treatment of employees.

The Province of Ontario has also been proactive in ensuring that commitments made to employees are respected. In the case of Ajax Precision Manufacturing moving from creditor protection into bankruptcy in 2005, Ontario enforced the Employment Standards Act to enable employees to collect severance that was owed them<sup>15</sup>. In the case of Mahle Engine Components<sup>16</sup>, an expert commission recommended maintenance and enhancement to the pension benefit guarantee fund. Other politicians have also championed the employee cause to ensure that they were fairly treated<sup>17</sup> and that companies were not able to ignore the spirit of the law.

These steps have been taken because there is growing recognition that employees are not like other involuntary unsecured creditors.<sup>18</sup> They have a special relationship with the debtor and are largely responsible for the creation of value for all stakeholders, especially in the new Creative/Knowledge economy.

---

<sup>13</sup> [Modernizing Part III of the Canada Labour Code](#)

<sup>14</sup> [Protecting Employee Wages in Bankruptcy \(PRB 01-34E\)](#)

<sup>15</sup> [Employees Get Nearly \\$900,000 Payout From Bankrupt Employer: Ontario Government's Proactive Approach Pays Off For Former Employees | Ontario Ministry of Labour](#)

<sup>16</sup> [TERMINATED SALARY EMPLOYEES & MEMBERS OF THE SALARY PENSION PLAN OF MAHLE ENGINE COMPONENTS SUBMISSION](#)

<sup>17</sup> [London plant spurs severance call](#)

<sup>18</sup> <https://www.lexmundi.com/images/lexmundi/PDF/PG/EmployeeClaimsInCanadianInsolvency.pdf>

Recognizing this, Canada passed Bill C-55<sup>19</sup> to amend the Corporate and Insolvency Policy, and introduced the Wage Earner Protection Program (WEPP)<sup>20</sup>, aimed at ensuring that employees receive owed compensation in the event of bankruptcy. This has started the process to protect employees in cases of bankruptcy<sup>21</sup>. In Budget 2009<sup>22</sup>, this program was extended to cover severance and termination and provided 5 additional weeks of Employment Insurance benefits, reflecting the need to contribute towards providing a reasonable transition to employees as they transition between jobs.

The United States also has passed bills to amend their Chapter 11 bankruptcy process to improve protections for employees and retirees in business bankruptcies<sup>23 24</sup> by increasing the maximum amount per individual or corporation of unsecured claims ranked in the fourth (wages, salaries, or commissions) and fifth (employee benefit plan contributions) order of priority.

Representing a large portion of Canada's workforce are some of Canada's large unions. They have recommended specific changes<sup>25 26</sup> to increase employees' priorities in settlements to a more appropriate status and to ensure timely payment of owed settlements versus waiting for years for the court proceedings to complete<sup>27</sup>. They were active in contributing to the priorities of Bill C-55, which served to improve the protection of workers' rights. More recently, unions have also successfully argued that employees "do not have the ability to investigate the solvency of a company as would a trade creditor or a bank. Workers are involuntary creditors to a business; their contracts should have special protection"<sup>28</sup> and as such they cannot have their contracts repudiated during CCAA proceedings. This was addressed in the 2006 case of GMAC/TCT Logistics

---

<sup>19</sup> [Corporate and Insolvency Law Policy - Bill C-55: clause by clause analysis](#)

<sup>20</sup> <http://www2.parl.gc.ca/HousePublications/Publication.aspx?pub=bill&doc=C-55&parl=38&ses=1&language=E&File=32>

<sup>21</sup> [Better rights for workers in bankruptcies - Chatham Daily News - Ontario, CA](#)

<sup>22</sup> [Budget 2009 - Budget Plan - Chapter 3: Action to Help Canadians and Stimulate Spending](#)

<sup>23</sup> [S.2092: A bill to amend title 11, United States Code, to improve protections for employees and retirees in business bankruptcies.](#)

<sup>24</sup> [H.R.3652: To amend title 11, United States Code, to improve protections for employees and retirees in business bankruptcies.](#)

<sup>25</sup> [Steelworkers campaign targets bankruptcy and insolvency laws](#)

<sup>26</sup> [USW Canada: Unfair, Unclear, and Unworkable: Why working people need changes in Canada's bankruptcy laws \(Policy Document\)](#)

<sup>27</sup> [Emergency Measures for Laid Off Workers | Canadian Auto Workers | CAW](#)

<sup>28</sup> [To repudiate or not?](#)

and 2007 case of Beta Brands, which argued that a Receiver or Monitor is a successor employer and liable for unpaid obligations of dismissed employees.

Much of the motivation of the government to act appears to stem from the cost to society of the lack of income security. In addition to the increased demand on social assistance programs that this causes, there are also health risks that increase pressure on health services and impacts on children<sup>29</sup>. The Federal Labour Code attempts to address the fundamental imbalance of power between workers and employers by protecting workers.

Company directors are viewed as the ultimate masters of a corporation and have always been expected to act in the best interests of the corporation. The legislatures and courts are expecting a higher standard of diligence from directors, holding them personally accountable for demonstrating that they have acted competently and in good faith<sup>30</sup>. In one case, that of Bata Industries, the court codified what it meant by due diligence in environmental matters, adding more rigor to what competence and good faith meant to them.

The weight of public opinion clearly demands the fair and equitable treatment of employees, and the evolution of obsolete laws in support of these goals. This imperative of fair and equitable treatment is being supported by various stakeholders as being in the best interests of the business going forward, a critical part of their restructuring plan and an essential element of ongoing company health.

#### **4. The Courts Are Defending Employee Rights and Are Modernizing the Laws**

Increasingly, a company's commitment to its employees is being given higher priority in the Courts, even in the case of bankruptcies. In several cases, the courts are supporting decisions for companies to meet their contracted commitment to their employees.

For example, in 2002 Worldcom won permission to pay remaining severance to employees laid off or noticed before filing for bankruptcy<sup>31 32</sup> in order to shore up employee morale. In the fall of 2008, Canadian employees of Quebecor World were informed that *"employee wages and benefits (including vacation, health benefits, severance benefits, sick leave), whether accruing before the filing or*

---

<sup>29</sup> <http://www.workersactioncentre.org/Documents/pdfs%20policy/Modernizing%20Part%20III-Oct%202005.pdf>

<sup>30</sup> [POISONED CHALICE?](#)

<sup>31</sup> [Laid-off WorldCom workers to get \\$36M -- baltimoresun.com](#)

<sup>32</sup> [Firm asks to pay big severance pacts -- baltimoresun.com](#)

*afterwards, have and will continue to be paid as and when due, and there is no need for you to file any proof of claim on account of such wage and benefits claims<sup>33</sup>.*” Even in the 2002 case of Enron<sup>34</sup>, the company began to pay owed severance to its former employees after it filed for bankruptcy.

This progressive action by the courts prevents employees from bearing the brunt of bad company decisions, and is helping companies to see beyond the very short-term and short-sighted financial-only health metrics of the company.

The courts are beginning to enforce the spirit of the law in employment cases, and the required changes are being made to update the laws to reflect the intent of providing fair and equitable treatment.

## **5. The Current CCAA Process Allows for Ongoing Changes to Decisions**

The Companies’ Creditors Arrangement Act (CCAA) also appears to provide companies with significant flexibility to treat employees properly.

The CCAA does permit the court to declare a person to be a critical supplier<sup>35</sup> if the contribution of goods or services being provided by the person is critical to the debtor’s continuing operation. Employees, including recently severed employees, clearly fall into this category in a knowledge-based business. As discussed in the case of Ledco in Kitchener Ontario<sup>36</sup>, CCAA would have given the company a chance to meet its employee obligations during its restructuring.

As described in Section 4 above, a company does have the opportunity to resolve employee severance issues in its restructuring plan. Company recommendations will be supported by the courts because they are in the best interests of the stakeholders, as discussed earlier in this report. In the 2005 case of Allied Holdings, the applicants provided clarification that severance agreements would be honoured in their follow-up request to extend the stay of proceedings<sup>37</sup>. This followed an earlier decision that precluded rejection of severance contracts with employees. Companies can file for these changes at their discretion, so it is never too late for them to meet the spirit of the law and de-risk the company’s way forward for all stakeholders.

---

<sup>33</sup> [http://www.quebecorworld.com/uploadedfiles/letterToCanadianEmployees\\_claims\\_En\(1\).pdf](http://www.quebecorworld.com/uploadedfiles/letterToCanadianEmployees_claims_En(1).pdf)

<sup>34</sup> [Enron Campaign Advances With Win in Fight for Fair Severance Pay](#)

<sup>35</sup> <http://www.torys.com/Publications/Documents/Publication%20PDFs/CM05-47T.pdf>

<sup>36</sup> [TheStar.com | Business | Bankrupt plant workers denied severance](#)

<sup>37</sup> <http://www.gowlings.com/restructuring/allied/NoticeofMotionreturnableOctober142005.pdf>



## **6. Why Companies Must Change Now**

A company's heart and soul are its people, and this is especially true in a knowledge-based company that relies on these people for the creation of its value proposition via innovation and customer service. Given the potential for the significant harm that can be done to a company's recovery efforts due to reduced morale associated with breaking a trust between the company and its employees, many companies opt for fair and equitable treatment of employees to protect their brand, their value proposition and their credibility in the marketplace. This can take the form of paying outstanding claims prior to bankruptcy and, in the event of bankruptcy, placing employees at the highest priority of creditors.

Over the past 50 years, obsolete laws have been changed to reflect modern values and current societal expectations. Among these changes have been granting women the right to vote, the granting of equal rights to minorities, the abolition of capital punishment, the creation of the Canadian Charter of Rights and Freedoms, and the list goes on. Archaic business practices, originally established in prior centuries, also need to be modernized.

## **7. Summary**

In summary, the fair treatment of employees is always in the best interest of all stakeholders of a company - even during times of financial crisis. The government and the courts are increasingly moving to protect the rights of the employee, which has a net benefit to society and has been shown to have a positive impact on companies. Laws are being evolved and modernized to reflect the importance of workers in a knowledge-based economy. Legal processes are in place that enable companies in bankruptcy protection to take positive action and to go before the Courts to ask that current and dislocated employees be given fair and respectful treatment so that they can maintain their bond with employees for the benefit of all stakeholders and the future success of the company.