



BONUSES HAVE TO BE PAID TO FIRED COMPANY EXECUTIVE DESPITE BREACH OF FIDUCIARY DUTY

Ruling that a lower court judge erred in overturning an arbitrator's decision that awarded earned bonuses to a company executive who had been fired after he was caught using the employer's resources and money to renovate his own house, the Ontario Court of Appeal held that fiduciaries who breach their duty are not automatically to be denied such bonuses. The Court held that the treatment of such bonuses is a matter of discretion based on the circumstances of each case, and that the arbitrator had exercised his discretion reasonably.

Ordered by an arbitrator to pay \$364,661.33 in unpaid bonuses to one of its employees whom it had fired for using its labour and materials to renovate his own house, a construction company successfully appealed the order to the Ontario Superior Court, which decision the employee appealed in turn.

Employed as an executive with Mady Development Corp., D. Mady Investments Inc. and Mady Contract Division Ltd. (collectively, "Mady"), Leonard Rossetto diverted labour and materials and used Mady's funds to renovate his house between September 3 and November 15, 2007.

Mady discovered his wrongdoing and terminated Rossetto's employment on December 12, 2008. The company subsequently sued Rossetto for damages for conversion, breach of employment contract, unjust enrichment, and breach of fiduciary duty. Rossetto counterclaimed in respect of his bonuses for 2007 and 2008. The parties ultimately submitted the dispute to arbitration. Mady framed its arbitration claim in relation to the diversion of resources as a claim for breach of fiduciary duty, taking the position that because Rossetto was terminated for cause, it was not obligated to pay his bonuses.

In a December 9, 2009 award, Arbitrator Stanley Beck awarded Mady damages totalling \$546,452, of which \$315,452 was for the misappropriated labour, materials and funds and \$231,000 was to compensate for the delay to one of Mady's projects caused by Rossetto's diversion of resources and attention to his home renovations.

Pursuant to his employment contract, Rossetto was entitled to an annual bonus equal to 30 percent of Mady's profits after overhead. Although the arbitrator found that Rossetto was a member of Mady's small executive group and a trusted individual within the Mady organization, and that it was arguable that he owed a fiduciary duty to the company, of which he was in breach, Beck held that it was "appropriate ... in this case to treat Rossetto as an employee whose terms of employment were set out in the contract, as amended, between



himself and Mady." Accordingly, ruling that Rossetto's entitlement to an annual bonus was "an integral part of his contract with Mady from the very first day he entered into his employment," Beck held that even a dishonest dismissed employee is entitled to be paid for the work that he has done, and awarded Rossetto \$364,661.33 in satisfaction of his unpaid bonuses for 2007 and 2008.

Mady appealed the arbitrator's decision that Rossetto was entitled to his bonuses to the Ontario Superior Court. In a decision released on November 17, 2010, Justice Beth Allen held that the arbitrator erred in law by failing to apply the principles that govern the remedies for breach of fiduciary duty, despite having found that Rossetto stood in a fiduciary relationship with Mady. Identifying in the caselaw an "overriding principle ... that a fiduciary is not entitled to compensation for the period of their wrongdoing," Justice Allen held that the only way to return Mady to its original position, as required for a breach of contract, was to deprive Rossetto of his bonus from the date of the breach onward. In her view, "had Mady been aware that Rossetto was secretly diverting the company's assets and resources from September 3, 2007, Mady would most assuredly have terminated Rossetto's employment contract as it did immediately upon discovering Rossetto's dishonest activities."

Rossetto appealed the denial of his bonuses to the Ontario Court of Appeal.

The Ontario Court of Appeal allowed Rossetto's appeal and reinstated the arbitrator's award of his bonuses, ruling that Justice Allen's conclusion was based on "the erroneous principle that, in all circumstances, errant fiduciaries forfeit entitlement to compensation in the form of bonuses."

In the unanimous decision of a three-member panel of the Court, Justice Alexandra Hoy held that the cases relied upon by Justice Allen did not establish that a fiduciary employee must, in all circumstances, be denied compensation in respect of the period of his wrongdoing. Rather, Hoy noted that these cases confirmed that such equitable relief is "discretionary and fact specific," aimed at the two goals of restitution, or returning a beneficiary to the position he would have been in but for the fiduciary's breach, and deterrence or "prophylactic purpose," to prevent fiduciaries from benefitting from their wrongdoing. According to Hoy: "The question of entitlement to bonus compensation is therefore fluid and must be determined by reference to the circumstances of the particular case, having regard to the general principles governing fiduciary relief."

In the case at hand, Hoy noted that the underlying breach was the diversion of labour, materials, and funds over a three-month period in 2007, for which damages had been

awarded to the company, whereas the bonuses at issue were for the whole of 2007 and 2008. In addition, noting that Arbitrator Beck had found that the bonuses were an integral part of Rossetto's employment contract, or "traditional performance bonuses," she held that an employer is not entitled to withhold payment of wages for past performance, even if the employee was in breach of his fiduciary duty at that time, as the employer had nevertheless received the benefit of the employee's labour.

Turning to the facts of this case, with the goals of restitution and deterrence in mind, Hoy determined that the arbitrator's conclusion was reasonable and consistent with the caselaw on fiduciary relief. She reasoned:

There are different kinds of bonuses. Some are discretionary. Some are simply a form of variable, as opposed to fixed, compensation. Sometimes, a bonus amounts to the principal form of compensation. In this case, the bonuses were significant and non-discretionary. The arbitrator found they were an integral part of Mr. Rossetto's compensation under the employment contract. He was just as entitled to the bonus component of his compensation as he was to his regular salary.

Hoy concluded that the arbitrator's award met the goals of fiduciary relief. In her words:

Mady suffered a tangible loss as a result of Mr. Rossetto's breach of fiduciary duty. That loss could be, and indeed was, compensated by the arbitrator's award for damages.... By requiring Mr. Rossetto to compensate Mady for the time, money and resources he misappropriated, as well as the delay occasioned by his conduct, Mady was put back in the same position it would have been in but for the breach; the goal of restitution on which the appeal judge focused was fully achieved.

The arbitrator's award also accounted for [the] prophylactic goal of fiduciary relief. It had the effect of depriving Mr. Rossetto of the benefit he gained from his wrongful conduct. This was not a case where Mr. Rossetto was left unimpaired by his wrongdoing. Mr. Rossetto lost his job. He was dismissed as soon as Mady became aware of his misconduct.

In the result, Justice Hoy on behalf of the Court allowed the appeal and restored the award of the arbitrator, remarking: "His reasons show that he was alive to the fiduciary relationship but concluded that it was nonetheless appropriate *on the facts of the case* to treat Mr. Rossetto as an employee. The conclusion he reached was reasonable and remains reasonable when viewed in the light of the fiduciary relationship. I would not interfere."



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