EMOND HARNDEN
LABOUR & EMPLOYMENT LAW
DROIT DU TRAVAIL ET DE L'EMPLOI

Firm held liable for misconduct of independent contractor

January 1, 2001

Many of our readers will be aware that the determination of whether someone is an independent contractor or part of the employer's organization can have important legal consequences, one of which is the employer's liability for wrongs committed by a supposed 'independent contractor' who is found to be an employee. Further, as *FOCUS* readers may recall, the employer need not itself be found to have been in any way blameworthy in order to be held liable. Under the doctrine of vicarious liability, the employer is liable for employees' wrongful acts where there is a significant connection between these acts and the employer's business, despite the lack of any negligence on the employer's part (see "A risky enterprise: Liability of employers for the wrongful acts of their employees" on our Publications page).

A recent decision of the Ontario Court of Appeal illustrates the issues employers should bear in mind when retaining the services of external contractors or consultants. The case, *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.* (January 25, 2000), arose when the plaintiff corporation, formerly called Design Dynamics Limited, lost a lucrative contract to supply Canadian Tire Corporation with synthetic seat covers. Design had been supplying the seat covers for 30 years when Canadian Tire decided in 1984 to give this business to Sagaz Industries.

TRIAL: DAMAGES AWARDED AGAINST MARKETING CONSULTANT, BUT NOT AGAINST SAGAZ

Later it emerged that Canadian Tire had been influenced to change suppliers by means of a bribe offered to the head of its automotive division. The bribe was the work of the owner of American Independent Marketing Inc. (AIM), a consulting firm engaged by Sagaz to market its seat covers.

Despite the corruption tainting the decision to award the contract to Sagaz, Canadian Tire subsequently determined that Sagaz's product was superior, and opted to remain with its new supplier. Design's business went into a decline from which it never recovered, and it commenced an action for damages for the loss of its business with Canadian Tire. Among the named defendants was Sagaz.

At trial, the judge found that Design had been the victim of AIM's conspiracy and unlawful interference with its business relations. However, the judge also found that AIM was an independent contractor and that Sagaz therefore could not be held vicariously liable for AIM's act of bribery, particularly given the lack of evidence showing that Sagaz knew of the bribery. He awarded Design damages of $1,857,500, plus $50,000 in punitive damages, and $3,381,613 in pre-judgment interest. Despite this sizable award, Design appealed the dismissal of its case against Sagaz.

APPEAL: A SEPARATE LEGAL ENTITY, BUT UNDER DIRECT SUPERVISION OF SAGAZ

The strongest evidence showing that AIM was an independent contractor was the written agreement between AIM and Sagaz, an agreement which unambiguously designated AIM as an entity distinct from Sagaz. However, the Court of Appeal held, it was the "true nature of the relationship" – not the parties' description of that relationship – that determined AIM's legal classification for the purposes of vicarious liability.

This approach requires that the facts of each case be scrutinized to determine the extent to which the contractor is integrated into the employer's business – the "organization test", described by the Court as follows: "[T]he "organization test" inquires into whether the agent or servant functions as part of the principal's organization and whether an agent's work is done as an integral part of the principal's business. If the answer to these questions is yes, the principal is liable for the tortious acts of the agent even though, as between themselves, the principal and the agent have chosen to designate the relationship as that of independent contractor."

Here, the Court stated, while it was true that AIM was a separate legal entity, it had worked "under the direct supervision and direction" of Sagaz, and had "no independent discretion on any significant matter" in pursuit of the contract with Canadian Tire. As evidence for its conclusion, the Court pointed to a number of facts: Sagaz, not AIM, had initiated contact with Canadian Tire; Sagaz provided both initial and revised price quotations; AIM worked jointly with Sagaz's sales manager, and required instructions on key aspects of the business it was conducting on Sagaz's behalf; AIM's role was limited to presenting prices that had been negotiated by Sagaz staff; AIM had used Sagaz letterhead in correspondence with Canadian Tire confirming the prices and terms under which Sagaz would be prepared to supply the seat covers.

All of this, the Court stated, led to the "inevitable conclusion" that AIM was "squarely within the 'organization test' for vicarious liability" and that Sagaz was therefore liable for the wrongful acts of AIM and its staff. However, the Court held that liability should not extend to the award of punitive damages, as the trial judge had found no evidence that Sagaz was aware of the bribery scheme.

In Our View

Engaging the services of external consultants does not ensure that employers will be shielded from liability for wrongful acts committed by these individuals. Even if the employer does not itself know of or participate in the misconduct, it will still have to demonstrate that the consultant or contractor was not integrated into its organization in a manner that will attract vicarious liability. This case gives some indication of factors to be considered in structuring a working relationship with external contractors.

For more recent developments, see "Supreme Court reverses Ont. C.A. ruling on liability for actions of independent contractor" on our Publications page.

EMOND HARNDEN
LABOUR & EMPLOYMENT LAW
DROIT DU TRAVAIL ET DE L'EMPLOI

For further information, please contact Colleen Dunlop at (613) 563-7660, Extension 222.