Into choppy waters – Canada's highest court creates waves for employers

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A very recent decision from the Supreme Court of Canada applies further pressure on employers in the area of "post-termination" incentive compensation. Employers may face increased claims from employees for such compensation, even for periods of time in which they are not working. However, there are steps that employers can take to mitigate risk from this new ruling.

In the *Matthews v. Ocean Nutrition Canada Ltd.* case, the Supreme Court of Canada awarded a former senior executive more than $1 million for the loss of a long-term incentive plan (LTIP) payment that he would have received during a 15-month notice period, among other things.

The background

Key facts of the case:

- Beginning in 1997, the former employee had occupied several senior management positions with Ocean Nutrition.
- Under Ocean Nutrition's LTIP, a "Realization Event", such as the sale of the company, triggered payments to employees who qualified under the LTIP.
- The employee eventually left Ocean Nutrition in June 2011 and alleged constructive dismissal. The trial judge found that a new COO, hired in 2007, engaged in a four-year "campaign", characterized by lies and dishonesty, to push the former employee out of operations.
- Approximately 13 months after the former employee's departure, Ocean Nutrition was sold and the sale constituted a "Realization Event" under the LTIP.
- Because the former employee was no longer working at Ocean Nutrition at that time, the employer took the position that the employee was not entitled to any LTIP payment.
- The former employee argued otherwise, alleging that he was constructively dismissed and entitled to the LTIP payment.

At trial, the court concluded that Ocean Nutrition had constructively dismissed the employee. The trial judge determined that the former employee was owed a notice period of 15 months. The Nova Scotia Court of Appeal agreed with the constructive

dismissal ruling and the 15-month notice period, but found that the former employee was not entitled to damages on account of the lost LTIP payment. The former employee appealed.

The applicable legal framework

The Supreme Court of Canada outlined two questions that courts should ask when determining whether an employee is entitled to payment under an LTIP or similar incentive plan:

1. Would the employee have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period?
2. If so, do the terms of the employment contract or bonus plan unambiguously take away or limit that common law right?

Since the Realization Event (*i.e*., the sale of business) occurred during the 15-month notice period and because the language of the LTIP did not clearly and unambiguously deprive the employee of this entitlement, the Supreme Court determined that he was entitled to the payment.

The Court reviewed the LTIP plan language, which indicated, among other things:

- That the employer had no obligation under the agreement to the former employee unless, on the date of a Realization Event, the former employee is a "full-time employee" of the employer; and
- That the LTIP agreement was of no force and effect if the employee "ceased to be an employee of [the employer], regardless of whether the employee resigned or is terminated, with or without cause".

This language was not clear enough in the eyes of the Supreme Court.

When considering the second question, the Supreme Court also mused that in certain cases, it may be appropriate to examine whether the clauses purporting to limit or take away an employee's common law right were adequately brought to the employee's attention. The Court further indicated that it may be appropriate to question whether the clause is compatible with minimum employment standards. However, the Court found that it was unnecessary to explore those points in the case at hand, having rested its decision on the language of the LTIP itself.

While this decision was rendered in Nova Scotia, a common law jurisdiction, it must be noted that most of the elements mentioned by the Court also apply to Québec, making this decision relevant in all Canadian jurisdictions.

Charting a safer course

In response to this new ruling, employers should consider taking the following steps with respect to incentive plans:

1. Review the termination of employment language in incentive plans, including bonus plans, LTIPs, RSU, phantom stock plans, and stock option plans. It may

be appropriate to reinforce the termination of employment language in those plans given this new ruling.

2. Bring to the employees' attention, ideally prior to the commencement of employment, the clauses that purport to limit or "take away" an employee's common law (or, to an extent, civil law) rights to incentive compensation during the notice period. This builds on the Supreme Court's musing that it may be appropriate in certain cases where the limiting or "take away" clauses were adequately brought to the employee's attention. The manner and logistics of bringing it to the employee's attention will have to be carefully decided by employers.
3. Assess whether those clauses are compatible with minimum employment standards legislation. The Supreme Court mused about this. Each jurisdiction may have different requirements, and employers with employees in multiple jurisdictions in Canada will want to consider this carefully from that multi-jurisdictional perspective as well.

Reach out to your trusted advisor at BLG to discuss how we can assist your organization mitigate risk against this new ruling.

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