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EMPLOYMENT LAW CONFERENCE 2017
PAPER 7.1

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HERE'S A BONUS: YOU'RE FIRED!

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I. Introduction

It is common for an employee to be entitled to a bonus, incentive payment, and/or profit sharing as part of his or her remuneration package. What comes of such entitlements upon the termination of the employment relationship? The answer depends on a number of considerations reviewed in recent decisions by Canadian courts.

The starting point for this analysis is the basic principle that the measure of damages arising out of the termination of employment is what the employee would have received had the employment contract been performed according to its terms**.** Generally speaking then, an employee is entitled to damages relating to bonuses, incentive payments, and/or profit sharing where he or she would have received such remuneration but for the employer's termination of the employment relationship, including, in some circumstances, those that may have become payable during the notice period.

Recent decisions have considered employee entitlement to these forms of payment in a variety of circumstances and in the context of differing contractual language.

II. Legal Test

In *Paquette v. TeraGo Networks Inc*., 2016 ONCA 618, the Ontario Court of Appeal endorsed a two-step process for determining whether a bonus should be included in a plaintiff's wrongful dismissal damages: paras. 30-31. The steps endorsed in *Paquette* are consistent with the approach taken in British Columbia (see, for example: *Saalfeld v. Absolute Software Corp*., **2009 BCCA 18).**

The first step is to consider the employee's common law rights. Where the bonus was an "integral part" of the terminated employee's compensation, he or she will be considered eligible to have received a bonus had the employment continued during the notice period. For example, in *Paquette*, the plaintiff's employment was terminated without cause in November 2014 and the employer paid annual bonuses, which were considered to be an integral part of his compensation, in February for the preceding year. Because the period of reasonable notice was determined to be 17 months, the plaintiff was found to have been eligible for a bonus in February of both 2015 and 2016.

The second step is to determine whether the applicable bonus plan or employment contract contains language that specifically removes the employee's common law entitlement. More specifically, the question is whether the wording of the employment contract or bonus plan unambiguously alters or removes the employee's common law rights. As discussed in further detail below, a requirement that the employee be "actively employed" on the date a bonus is payable, without more, may not be sufficient to limit the employee's common law entitlement.

While most of the cases below address entitlement to damages for bonuses, some also consider damages for profit sharing plans such as employee stock options. Without deciding expressly whether the same test applies to stock options as to bonus payments, the Ontario Court of Appeal in *Paquette* noted the "similarity" in approaches.

III. Step 1—"Integral Part"?

In order to determine whether an employee's bonus plan is an "integral part" of his or her compensation, the following factors, recently endorsed in *Bain v. UBS Securities Canada Inc*., 2016 ONSC 5362, para. 83, and *Ostrow v. Abacus Management Corporation Mergers and Acquisitions*, 2014 BCSC 938, para. 122, are considered:

(a) Was the bonus received each year (although in different amounts)?

(b) Were bonuses required to remain competitive with other employers?

(c) Have bonuses been awarded historically (and has the employer ever exercised its discretion against the employee)?

(d) Did the bonus constitute a significant component of the employee's overall compensation?

In *Bain*, the Court held that it was "clear" on the above factors that the employee's bonus was an integral part of his remuneration. The plaintiff had received the bonus annually (in different amounts) every year for 14 years of employment, and it was a significant component of his income (ranging from 66 to 91 percent of his total compensation). Further, he had negotiated a minimum bonus as a term of his employment contract. Whether the employer required the bonus to remain "competitive" in the industry was not expressly considered.

The bonus in question in *Ostrow* was also found to be an integral part of the employee's compensation, in circumstances where the four factors above were less clear. The plaintiff was a short-service employee, having been employed by the defendant for only nine months. He had only been paid a bonus once during his employment; however, his employment agreement provided for a contractual right to a bonus (in the range of 15% of his income) and the agreement had been subject to negotiations. Again, whether the bonus was required for the employer to remain "competitive" was not expressly considered by the Court.

That a bonus is "discretionary" will not necessarily preclude a finding that it is an integral part of the employee's compensation. For example, the employment agreement in *Bain* stipulated that any bonus in excess of the agreed upon minimum would be in the sole discretion of management. The Court concluded the employer was still obliged, however, to follow a fair (at para. 108):

> An employer is not bound to administer the bonuses in the same fashion each year; circumstances change, particularly in a volatile industry such as investment banking. However, the process followed must be fair and consistent among similarly situated employees. The fact that an employee is terminated because his job is redundant does not relieve the employer from exercising its discretion fairly.

A discretionary bonus in *Damani v. Stuart Olson Construction Ltd*., 2015 BCSC 2322, on the other hand, was not awarded to the plaintiff employee. The employment contract provided that all bonuses were entirely discretionary on the part of the employer: the bonus "may or may not be paid in any given year" and the employer could "in its sole discretion unilaterally amend the timing of the bonus payment or discontinue the discretionary bonus plan at any time".

There was no evidence on summary judgment that any bonus had been paid for the year prior to the plaintiff's dismissal. Further, the termination provision of the employment contract limited her payment in lieu of notice to two weeks of "regular wages" per year of service, and thus she would not have been "actively employed" (as required by the bonus plan) at the time the bonus would have been paid, even considering the contractual notice period. The defendant's application for summary judgment was granted.

IV. Step 2—Contractual Limitations?

The sole issue before the Alberta Court of Appeal in *Styles v. Alberta Investment Management Corp*., 2017 ABCA 1[1], was whether the employee was entitled to bonuses under the employer's long term incentive plan ("LTIP"), which the trial court had found were payable. According to the terms of the LTIP, four years of employment were required before any bonus would become payable. The employee in question had been terminated without cause after three years of service and had received three months' pay in lieu of notice in accordance with the termination provision of his employment contract.

The terms of the LTIP were extensive. Notably, it provided as follows:

> Eligibility for Payment:
>
> Unless otherwise stipulated, participants must be actively employed by AIMCo, without regard to whether the Participant is receiving, or will receive, any compensatory payments or salary in lieu of notice of termination on the date of payout, in order to be eligible to receive any payment.
>
> As per the guidelines above, entitlement to an LTIP grant, vested or unvested, may be forfeited upon the Date of Termination of Active Employment without regard to whether the participant is receiving, or will receive, any compensatory payment or salary in lieu of notice of termination.
>
> "Date of Termination of Active Employment" means the termination date specified by AIMCo in the termination notice.

Relying on this language to allow the appeal, the majority of the Court of Appeal concluded the terms of the LTIP "left no doubt" that the employee had to be actively employed on the vesting date and that any period of reasonable notice required in lieu of notice of termination did not qualify as "active employment". That continued employment on the vesting date was required for entitlement to the bonus was a condition repeated in the LTIP and accompanying documents in no less than six places.

The Court of Appeal further concluded the denial of the bonus payment in *Styles* was not an exercise of the employer's "discretion". While the trial judge had relied on a "common law duty of reasonable exercise of discretionary contractual powers" (citing *Bhasin v. Hrynew*, 2014 SCC 71), the Court of Appeal held that no discretionary decision had been made by the employer. Properly

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1 Application for leave to appeal filed as of March 1, 2017: [2017] S.C.C.A. No. 76.

interpreted, the terms of the LTIP provided no right for the employee to receive a bonus unless he was actively employed on the vesting date. The Court of Appeal held the phrase "may be forfeited" (relied on by the trial judge) in the terms excerpted above was not intended to introduce an element of discretion. Further, the termination of employment was not an exercise of "discretion", as an employer can terminate a contract of employment without explanation as long as reasonable notice is provided. It is the failure to provide notice or pay in lieu thereof which, if it occurs, is the breach of the contract – not the termination itself.

By contrast, in *Paquette*, the Ontario Court of Appeal held that a contractual requirement that an employee be "actively employed" by the employer on the date of the bonus payout did not disentitle him from a bonus. The bonus plan (which in this case formed part of the employment contract) provided no clear definition as to what was meant by "actively employed" and did not limit the employee's right to receive compensation for the lost bonus (at para. 47):

> A term that requires active employment when the bonus is paid, without more, is not sufficient to deprive an employee terminated without reasonable notice of a claim for compensation for the bonus he or she would have received during the notice period, as part of his or her wrongful dismissal damages.

The plaintiff was compensated both for the loss of the bonus that would have been payable four months into his notice period and for the lost opportunity to earn a bonus in the subsequent year.

A similar conclusion was reached by the Ontario Court of Appeal in *Lin v. Ontario Teachers' Pension Plan Board*, 2016 ONCA 619, where the Court considered the language of two different bonus plans, one short-term ("AIP") and the other long-term ("LTIP") (together, providing for bonus payments that comprised roughly 60% of the plaintiff's compensation). The terms of the bonus plans in effect at the time of dismissal provided that no bonuses would be paid in the event employment was "terminated by [the employer]" either "prior to the payout of a bonus" (for the purpose of the AIP) or at a time when the grants earned toward the bonus have "not yet vested" (for the purpose of the LTIP). At the time of his dismissal in 2011, the plaintiff was an eight-year employee. Cause was alleged by the employer but not established.

The trial judge and the Court of Appeal rejected the assertion that these terms restricted the employee's entitlement to compensation for lost bonuses on wrongful dismissal. Echoing the decision in *Paquette*, the Court of Appeal stated (at para. 89):

> The wording does not unambiguously alter or remove the respondent's common law right to damages, which include compensation for the bonuses he would have received while employed and during the period of reasonable notice. A provision that no bonus is payable where employment is terminated by the employer prior to the payout of the bonus is, in effect, the same as a requirement of "active employment" at the date of bonus payout. Without more, such wording is insufficient to deprive a terminated employee of the bonus he or she would have earned during the period of reasonable notice, as a component of damages for wrongful dismissal: [citations omitted]

Also at issue in *Lin* was whether the employer could rely on amendments, purportedly made in 2010, to the wording of the AIP and LTIP. When the employer had attempted to introduce the changes to affected employees, with a request to employees to sign off on the changes and indicate they agreed with the revised terms, there was "almost unanimous negative reaction" from the employees. The plaintiff, among others, refused to sign the letters. The evidence at trial was that the employer withdrew the request for signatures as a result of the opposition and made no effort to communicate to employees that the changes would take effect.

The purported amendments for both the AIP and LTIP provided that an employee whose employment was terminated for any reason "shall on the Termination Date forfeit any and all rights to be paid a bonus". The phrase "Termination Date" was defined as follows (at para. 64):

> The date on which a Participant ceases to be employed by or provide services to [the employer] and, for greater certainty, does not include any period following the date on which a Participant is notified that his or her employment or services are terminated (whether such termination is lawful or unlawful) during which the Participant is eligible to receive any statutory, contractual or common law notice or compensation in lieu thereof or severance payments unless the Participant is actually required by [the employer] to provide services during such notice period.

The trial judge concluded (and the Court of Appeal upheld) the 2010 amendments did not form part of the plaintiff's employment contract, as such a "highly material change … could not be imposed unilaterally", and instead required the employee's consent. The trial judge went on to note that, had he concluded that the amendments formed part of Mr. Lin's employment contract, he would have concluded that the amendments resulted in penalties from which relief should be granted. The Court of Appeal did not comment expressly on the enforceability of the above provision.

A similar issue regarding the employee's acceptance of new bonus plan terms arose in *Bain*. On finding the employee's bonus was an integral part of his remuneration, the Court considered the employer's argument that the plaintiff had agreed to new terms in 2011 that precluded him from receiving a bonus if he were no longer employed with the company at the time the bonus was paid. The plaintiff's employment was terminated in 2013, around the same time that the bonus for 2012 would normally be paid. He received no bonus payment for 2012 or the portion of 2013 he worked.

The employer's argument regarding the "new terms" of the bonus plan failed, as no evidence suggested the 2011 terms had ever been brought to the plaintiff's attention, discussed with him, or accepted by him in order to alter his employment contract. Other terms of the compensation plan documents also contradicted the employer's position on this point.

As in *Paquette*, *Lin*, and *Bain*, the contractual terms in *McLeod v. Lifelabs BC LP*, 2015 BCSC 1857, were held to be insufficient to limit the employee's common law entitlement to the employer's bonus. The plaintiff had been employed by the defendant for more than 25 years when she was terminated without cause effective December 2014. She was awarded 18 months' reasonable notice.

The plaintiff had routinely received an annual bonus (or "STIP award") for a number of years, which she regarded as a consistent and significant portion of her remuneration. The terms of the bonus program changed from one year to the next and employees were required to sign off on the details for each upcoming year. One requirement of bonus eligibility was that an employee had to be employed for three months of the fiscal year (which ended in October) in order to be eligible for the bonus. Because the plaintiff's termination was effective December 2014, she had not worked the required minimum of three months of the 2015 fiscal year.

In considering these issues, the Court first concluded the bonus plan was an "integral part" of the plaintiff's compensation, having applied the four factors described above (and noting that "common sense" dictated that a bonus in the range of 10% of base salary would be an incentive). The contractual language that purported to limit entitlement to the bonus was held to be "vague and inconsistent". In particular, the terms "terminated" and "termination" were not defined, and the qualifier "involuntary" was used inconsistently. The plaintiff was found to be entitled to her bonus on a pro-rated scale to the end of the 18-month notice period.

V. What about Cause?

Not surprisingly, employers will generally be reluctant to pay a bonus, usually used to attract or incentivize employees, to an employee who is departing – particularly where the departure is based on performance concerns. Employees terminated for cause are, of course, not entitled to pay in lieu of notice, but are entitled to all pay earned prior to the termination.

In *Lin*, where cause was alleged but not established, the trial judge reasoned that even if there had been cause for termination without notice, the AIP and LTIP payments for 2010 were vested by the time of Mr. Lin's termination and were payable in any event. The Ontario Court of Appeal did not comment on this point.

On the other hand, the trial judge in *Clarke v. Syncrude Canada Ltd*., 2013 ABQB 252, aff'd 2014 ABCA 362, held that it was "an implied term of any performance-based bonus scheme" that the discretion to deny payment includes "the ground of an employee's repudiation of the employment contract". In that case, a 21-year employee was terminated for cause following a work event where he sexually harassed several women and sexually assaulted at least one. His claim for entitlements due upon termination was dismissed almost entirely, including claims for payment of a bonus for the year in which the misconduct occurred and for unvested stock options. These issues were not the subject of appeal.

VI. Conclusion

Unpaid bonus, incentive payments, or profit sharing may provide a departing employee with incentive to seek damages on termination. Where a bonus or other entitlement can be properly characterized as an "integral part" of an employee's compensation, he or she will generally be entitled to receive the payment during a period of notice. In the absence of unambiguous and enforceable contractual language, the employer's termination of the employment relationship will not generally avoid this liability.

Employers can contract out of the requirement to pay bonuses or profits to departed employees through careful and consistent language in employment agreements and bonus plans with clearly defined terms. Stipulations that payment of a bonus is "discretionary", that it requires "active employment", or that it will not be paid on "termination", without more, may not be sufficient to limit an employee's entitlement, and the importance of careful drafting cannot be overstated. Moreover, where the employer seeks to introduce new terms that purport to limit entitlement, such terms must be accepted by the employee in order to be enforceable at the end of the employment relationship.

Courts will undoubtedly continue to consider entitlement to damages for bonuses, incentive payments, and/or profit sharing following dismissal in context. However, the recent cases considered above establish clear goalposts for employment lawyers to aim for.