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Supreme Court Clarifies Employee Incentive Plan Entitlements During Notice Period

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On October 9, 2020, the Supreme Court of Canada released its decision in Matthews v. Ocean Nutrition Canada Ltd*.* It confirmed that where terminated employees would be entitled to a bonus or other incentive payments during the reasonable notice period, employers must use clear and unambiguous language to remove or limit their common law rights. The Supreme Court also distinguished between the obligation to provide reasonable notice of termination and a breach of the duty to exercise good faith in the manner of dismissal.

Background

David Matthews was a senior chemist employed by Ocean Nutrition Canada (Company). During his employment, he participated in the Company's long-term incentive plan (LTIP). The LTIP stipulated that upon a "Realization Event", which included the sale of the Company, qualifying employees would receive a payment. Matthews resigned after a change in the Company's management brought about, among other things, a significant reduction in his duties. He did so despite his suspicion that the Company may soon be sold, and the fact that he would have been a "qualifying employee" under the LTIP had he been employed by the Company at the time of the sale.

Approximately 13 months after Matthews departed, the Company was sold for $540 million. Matthews then sued the Company for constructive dismissal alleging that his constructive dismissal had been carried out in bad faith and constituted a breach of the Company's common law duty of good faith, both of which entitled him to, among other things, a payment under the LTIP.

The LTIP contained the following terms:

- 2.01 PAYMENT OF EXECUTIVE INCENTIVE: Provided the conditions precedent set out in Section 2.03 are satisfied on the date on which a Realization Event occurs, ONC shall pay to the Employee, in cash, less any appropriate withholding of other taxes, an amount calculated in accordance with Section 2.02, which payment shall be made within thirty (30) days of such Realization Event.
- 2.03 CONDITIONS PRECEDENT: ONC shall have no obligation under this Agreement to the Employee unless on the date of a Realization Event the Employee is a full-time employee of ONC. For greater certainty, this Agreement shall be of no force or effect if the employee ceases to be an employee of ONC, regardless of whether the Employee resigns or is terminated, with or without cause.
- 2.05 GENERAL: The Long Term Value Creation Bonus Plan does not have any current or future value other than on the date of the Realization Event and shall not be calculated as part of the Employee's compensation for any purpose, including in connection with the Employee's resignation or in any severance calculation.

Lower Court Decisions

The judge at first instance found that Matthews had been constructively dismissed, determined the reasonable notice period to be 15 months, and ruled that he was entitled to damages in lieu of the LTIP payment. The judge relied on the decisions of the Ontario Court of Appeal in *Paquette v. TeraGo Networks Inc.* (*Paquette*) and *Lin v. Ontario Teachers' Pension Plan Board* in finding that Matthews would have been entitled to the LTIP payment had he not been constructively dismissed. Moreover, the judge found that the LTIP plan did not unambiguously remove his common law right to damages.

The Company appealed and a majority of the Nova Scotia Court of Appeal allowed the appeal in part.

The Court of Appeal upheld the judge's findings that Matthews had been constructively dismissed and that the appropriate notice period was 15 months. However, a majority of the Court of Appeal found that he was not entitled to damages in lieu of the LTIP payment. It stated that the proper question to ask was "whether the employee qualifie[d] pursuant to the terms of the agreement." The Court of Appeal held that Matthews did not qualify for the LTIP because the LTIP itself contained "plain and unambiguous language" requiring as a condition precedent that an employee be employed by the Company on the date the Company was sold, and Matthews was not employed on that date. Further, the LTIP clearly stated that it could not be used for severance purposes.

At the Supreme Court

In the unanimous decision of the Supreme Court, Kasirer J. addressed two issues:

1. Whether Matthews is entitled to damages in lieu of the LTIP payment, and if so, on what basis, and
2. Whether Matthews' constructive dismissal breached the Company's common law duty of good faith and/or was committed in bad faith.

Entitlement to the LTIP Payment – The Duty to Provide Reasonable Notice

The Supreme Court agreed with the trial judge that the Matthews was entitled to receive damages equal to what he would have received during the 15-month reasonable notice period, including damages in lieu of the LTIP payment, subject to mitigation. It agreed with the analytical framework from *Paquette* in assessing damages where the dismissed employee participates in an incentive plan. A court should first ask, "Would the employee have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period?" and second, "If so, do the terms of the employment contract or bonus plan unambiguously take away or limit that common law right?"

The Supreme Court did clarify one aspect of the application of *Paquette*. It noted that the question of whether a bonus is "integral" to an employee's compensation will be helpful where a bonus is discretionary and there is doubt as to whether the bonus would have been paid during the reasonable notice period. However, if it is otherwise clear that but for the termination, the employee would have received the bonus during the reasonable notice period, there is no need to ask whether the bonus was integral to the employee's compensation.

The Supreme Court found that Matthews would have been entitled to the LTIP payment as part of his compensation during the 15-month reasonable notice period and that the terms of the LTIP did not clearly and unambiguously take away or limit that right. Unfortunately for employers, the Supreme Court did not provide any guidance on what language would be sufficient, or what the finding might be if multiple variations of wording are combined together.

The Supreme Court did not address whether the LTIP clause may have violated minimum employment standards, nor whether the clauses attempting to limit Matthews' common law damages were brought to his attention.

Good Faith

With respect to Matthews' arguments regarding the common law duty of good faith and allegations of bad faith on the part of the Company, the Supreme Court confirmed that such claims are separate and apart from the assessment of damages for wrongful dismissal: "the obligation to provide reasonable notice does not, in theory, turn on the presence or absence of good faith." Allegations of bad faith or a breach of the duty of good faith should not operate to "bump-up" a reasonable notice period. They are distinct, which is evidenced by, among other things, the fact that claims of mental distress or bad faith are not subject to mitigation.

While calculated differently, such damages “can serve as a basis to answer for foreseeable injury that results from callous or insensitive conduct in the manner of dismissal.” However, the Supreme Court was careful to note that damages for bad faith conduct cannot be deployed to provide what amounts to double recovery (e.g. damages for LTIP as part of the reasonable notice assessment and damages for LTIP as part of the bad faith conduct assessment).

Finally, despite being urged by Matthews and several interveners that the general organizing principle of good faith described in *Bhasin v. Hrynew* should result in a mutual obligation of loyalty *throughout* the whole of the contractual performance, the Supreme Court declined to make any such finding. It noted that this argument was a serious one, and whether the law should recognize such a mutual duty was a matter of fair debate. The Supreme Court also refrained from making a formal declaration of any contractual breach related to good faith as Matthews had not provided any explanation as to the basis upon which it could do so.

Conclusion

Before the Supreme Court’s decision in Matthews v. Ocean Nutrition Canada Ltd., the appellate jurisprudence in Ontario created stringent requirements for excluding incentive payments during the reasonable notice period from the calculation of damages. In affirming that case law, the Supreme Court has confirmed a high standard on employers that wish to limit employee incentive entitlements during the notice period.

Employers in all common law jurisdictions in Canada are encouraged to review their incentive plan language in light of this decision.

Should you wish to have your incentive plans reviewed, please contact any member of our Pension, Benefits and Executive Compensation Group.