

# Goodmans<sup>LLP</sup> Update

## Supreme Court Confirms that Bonuses Under Incentive Plans May be Included in Damages Awarded for an Employer's Failure to Give Reasonable Notice of Termination

In *Matthews v. Ocean Nutrition Canada*, the Supreme Court of Canada ruled that employees terminated without reasonable notice are entitled to payouts they would have otherwise received under incentive plans during the reasonable notice period, unless those plans contain “absolutely clear and unambiguous” language to the contrary. This is a significant decision for many employers, who are encouraged to review and revise their incentive plans and employment agreements.

### Background

Between 1997 and 2011, Mr. Matthews was employed by Ocean Nutrition Canada (“**Ocean**”), first as a chemist and later in several senior management positions. As a senior executive, Mr. Matthews participated in Ocean’s long term incentive plan (“**LTIP**”), under which he was eligible for certain bonuses and payments. The LTIP entitled Mr. Matthews to a payout should Ocean be sold during his employment, but only if Mr. Matthews was a “full-time employee” at the time of the sale. The LTIP would be “of no force and effect” when Mr. Matthews’ employment with Ocean ceased, regardless of whether he resigned or was terminated, with or without cause. The LTIP further provided that it was not to be “calculated as part of the Employee’s [Mr. Matthews’] compensation for any purpose, including in connection with the Employee’s resignation or in any severance calculation.”

In 2007, Ocean hired a new Chief Operating Officer (“**COO**”), who came to dislike Mr. Matthews and began a prolonged “campaign” to marginalize him. Mr. Matthews’ responsibilities and the number of personnel reporting to him were reduced, and the COO was intentionally dishonest with Mr. Matthews concerning his status at, and future prospects with, Ocean.

Mr. Matthews remained at Ocean for four more years, in part motivated by his belief that the company would soon be sold and he would be entitled to a substantial payout under the LTIP. However, in 2011 Mr. Matthews resigned and found a new job. Ocean was sold 13 months later.

Ocean’s management denied Mr. Matthews any payout under the LTIP in connection with this sale, arguing that he was not an employee of Ocean at the operative time. Mr. Matthews sued Ocean for wrongful termination, arguing that the reduction of his responsibilities and changes to his duties over the years amounted to constructive dismissal. Mr. Matthews argued that he was therefore entitled to a reasonable notice period of 15 months (the “**Notice Period**”), which meant he was also entitled to a payout under the LTIP, as the sale of the company occurred during the Notice Period.

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## Lower Court Decisions

At trial, the Nova Scotia Supreme Court (the “**NSSC**”) found that Mr. Matthews had been constructively dismissed and was therefore entitled to 15 months of pay in lieu of reasonable notice. The NSSC determined that Mr. Matthews was entitled to payment under the LTIP because the sale of Ocean occurred within the Notice Period, during which time he would have been employed by Ocean but for the constructive dismissal. The NSSC held that the exclusionary language in the LTIP did not unambiguously remove Mr. Matthews’ common law right to damages, and was therefore insufficient to prevent him from collecting payment under the LTIP.

The Nova Scotia Court of Appeal (the “**NSCA**”) agreed that Mr. Matthews had been constructively dismissed and was therefore entitled to 15 months’ reasonable notice. However, the NSCA disagreed with the lower court’s verdict that Mr. Matthews was entitled to a payout under the LTIP, holding that the NSSC failed to give sufficient weight to the written terms of the LTIP. In the NSCA’s view, these terms made clear that eligibility for a payout was predicated on an employee’s continued active employment with Ocean. The NSCA also identified a distinction between Mr. Matthews’ entitlement to payment under the LTIP and his right to reasonable notice of termination at common law.

## The Supreme Court’s Decision

### *The Two-Part Test for Calculating Damages*

The Supreme Court (the “**SCC**”) unanimously overturned the NSCA’s decision, finding that an employee terminated without reasonable notice is entitled to damages incorporating any compensation they would otherwise have received during the notice period, unless they are party to an agreement with their former employer that clearly and unambiguously restricts or removes such entitlements. To determine whether this compensation should include bonuses or payments potentially owed under an incentive plan such as Ocean’s LTIP, the SCC established that courts should rely upon the following two-part test:

1. Would the terminated employee have been entitled, but for the termination, to the bonus or benefit as part of their compensation during the reasonable notice period they should have received?
2. Do the terms of the terminated employee’s employment agreement or incentive plan specifically and unambiguously remove or restrict their common law right to compensation upon termination?

If the answer to the first part of this test is affirmative and the answer to the second part is negative, then the bonuses and incentive plan payouts to which the terminated employee would have been entitled during the reasonable notice period should be incorporated into any quantum of damages awarded by the court.

### *The “Absolutely Clear and Unambiguous” Language Requirement*

With respect to the second element of the test, the SCC indicated that employers are required to meet a high threshold in order to establish that the provisions of the agreement or incentive plan in question restrict or remove a common law entitlement. Although the SCC did not explicitly define what constitutes “absolutely clear and unambiguous” language, it did establish that provisions requiring an employee to be “active or “full-time”, as well as provisions purporting to remove an employee’s common law right to damages upon termination “with or without cause” were insufficient to meet this standard. The SCC specifically noted that Mr. Matthews’ LTIP entitlement did not arise as damages upon termination but instead arose in the context of the Notice Period following termination. As a result, the SCC held that waiving common law rights in connection with the termination was not sufficient to remove such rights arising during the Notice Period following termination.

## *The Employer's Duty of Good Faith*

Mr. Matthews argued that Ocean had constructively dismissed him in breach of its “duty of good faith”. The SCC declined to decide whether a contractual breach based on bad faith had occurred. The SCC did, however, note that the breach of the duty of good faith in an employment arrangement is a “distinct contractual breach” to be considered on its own merit, rather than only in connection with any failure to provide reasonable notice of termination, and this breach could give rise to distinct damages, although should not be used to permit double recovery. The SCC further discussed that in assessing cases of alleged bad faith termination, courts are not restricted to contemplating the circumstances of the termination alone, and may also examine periods of conduct not confined to the exact moment of termination.

## *Implications for Employers*

*Matthews* is the latest in a recent line of Canadian judicial decisions which have drastically elevated the standard of precision, clarity and even prescience to which employment agreements and incentive plans that purport to restrict an employee's common law entitlements are held. In light of *Matthews*, only employment agreements, incentive plans and equity grants with “absolutely clear and unambiguous” language, and which contemplate the precise situation at issue before the court, will be sufficient to exclude common law termination entitlements. Ambiguities will almost invariably be construed in favour of the employee.

Employers are therefore encouraged to review their incentive and bonus plans, as well as their employment agreements. Any provisions purporting to restrict the availability of entitlements under these plans which are not completely clear and unambiguous should be redrafted.

For further information concerning these developments, please contact any member of our [Employment & Labour Group](#).