



You get what you bargain for: Alberta Court of Appeal returns certainty to employers in respect of discretionary incentive plans

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In its first **decision** of 2017, the Alberta Court of Appeal has handed employers a significant victory in holding that there is “no common law duty of reasonable exercise of discretionary contractual powers”. This decision alleviates the significant uncertainty that was created by the **trial decision** in *Styles v Alberta Investment Management Corporation* (discussed in **our earlier blog**), namely that the courts might actively rewrite employment contracts based on vague principles of “fairness” and “reasonableness” and that employers are required to give reasonable justifications for terminating their employees.

Background and Trial Decision

In 2015, the trial court ruled that Mr. Styles was owed more than \$400,000 under a long term incentive plan (LTIP) after he was terminated without cause and denied payment of several LTIP bonus grants. Mr. Styles was employed for approximately three years. In each of these years he was awarded a sizable discretionary LTIP grant. Under the terms of the LTIP, once accepted by an employee, a grant would be invested for the employee’s benefit before vesting four years later.

The trial court seized on the wording of the LTIP, which provided that the grants “may be forfeited” if the employee was not actively employed on the vesting date and interpreted the LTIP as providing the employer with a discretion that had to be exercised “fairly and reasonably”. This principle was imported as an extension of the duty to honestly perform contractual obligations established by the Supreme Court of Canada in *Bhasin v Hrynew* (also discussed in an earlier **blog**). The trial judge concluded that the employer’s discretion to forfeit the grants which had not vested was contrary to the employee’s reasonable expectations, notwithstanding the clear wording of the LTIP.

The trial court also found that the employer’s decision to terminate the employee without cause was a “discretion” that had to be exercised reasonably, in particular by providing a reasonable explanation to the employee for a denial of a “legitimate contractual interest” such as the grants.

Court of Appeal Decision

In reversing the trial decision, the Court of Appeal emphasized that the unambiguous language of the LTIP “left no doubt that any period of ‘reasonable notice’ required in lieu of notice of termination did not qualify as ‘active employment’”, and that it was clear that Mr. Styles was not actively employed on the date that the bonuses might have vested. The Court of Appeal concluded that Mr. Styles was not entitled to receive any bonus and that the employer’s refusal to pay a bonus in any case was not properly interpreted to be discretionary under the LTIP.

The Court of Appeal also rejected the trial court's characterization of a decision to terminate an employee without cause as discretionary. It reiterated an employer's fundamental right to determine its own workforce by terminating an employee without cause, stating that "no explanation need be given". The Court added that an employee is not entitled to compensation as if the contract were not terminated even if the employer does not provide a reasonable basis for the employee's termination without cause. It concluded, "[n]o employment, no vesting, no bonus".

Notably, the Court of Appeal commented on *Bhasin*, stating that it "does not establish any general principle of 'reasonable exercise of discretion' in contractual performance. This radical extension of the law is unsupported by authority, and contrary to the principles of the law of contract". The Court of Appeal further held that *Bhasin* should not be used to rewrite contracts or award damages to contractual parties that the court regards as "fair" despite such damages being clearly unmerited in accordance with the contract. Mr. Styles bargained for bonuses that would vest only after four years of continuous employment. He failed to earn the bonuses under the LTIP as they never vested. It follows that he has no entitlement to the bonuses, in part or at all.

Discretion in Ontario

In contrast to *Styles*, a recent Ontario case indicates that the courts may review an employer's reasonable exercise of discretion in contractual performance. In the recent case of *Fraser v Canerector Inc*, the Ontario Divisional Court upheld a motion judge's summary judgment [decision](#), finding in favour of an employer who denied an employee the right to an annual bonus during the employee's reasonable notice period following the termination of his employment.

The offer of employment allowed the plaintiff to participate in the defendant's "discretionary" executive bonus program and, in each of the three years leading up to the termination of his employment, the plaintiff had received annual bonuses of \$50,000, \$75,000, and \$175,000. Once terminated, the plaintiff argued that he was entitled to the bonus during the notice period.

Contrary to other cases on this issue (discussed in detail [here](#)), the motion judge found that the plaintiff was not entitled to a bonus during the notice period, "both because the bonus plan in question implicitly required participants to be employees at the time the assessment process is undertaken after year end and because the plan itself was fundamentally discretionary and subjective". The motion judge added that "the court is in no position to sit as a court of appeal weighing allegedly unfair bonus calculations ... based on allegations that a particular decision" is unfair. The motion judge concluded that:

I have not been pointed to any cases where the courts have found an entitlement to [a] bonus arising from a discretionary plan such as this without any formula to turn to. I decline to invent such an entitlement when doing so would, in my view, run plainly contrary to the reasonable expectations of the parties in this case.

On appeal, the Court considered it problematic that the motion judge implied a term that the employee had to be actively employed after year end in order to be considered for bonuses, as no such requirement was clearly communicated to the employee in writing at any time and there was no evidence to support a finding that he had to be present at the time of the assessment process to receive a bonus. However, this did not affect the appeal for two reasons: first, there was no evidence that the bonus had been denied because the employee was not present at the time of assessment; and, second, the motion judge's decision that the employee was not entitled to the bonus was reached on the basis of both the fact the employee was not present during the assessment and because of the discretionary nature of the plan.

Although the employee acknowledged that the bonus plan was discretionary, he argued that the employer had an obligation to exercise its discretion "in a fair and reasonable manner" using objective criteria. While the Court found that by accepting the offer of employment, the employee "freely agreed" that the

bonus was subject to a discretionary determination, which “decision prevails for better and for worse, in good times and in bad”, it nonetheless went on to consider whether the employer had exercised its discretion reasonably. The Court held that the reasonable exercise of discretion by the employer did not support awarding a bonus given that there was no evidence that the divisions the employee managed were profitable or that his efforts had had a positive impact on the employer.

Guidance for Employers

The Court of Appeal’s reversal of *Styles* is welcome news to employers. Absent a successful appeal to the Supreme Court of Canada, it appears that no duty of reasonable exercise of discretionary contractual powers exists in Alberta and that employers may safely rely on incentive plans that contain clear and unambiguous language to deny entitlement to any unvested benefits to employees who are terminated without cause. Moreover, Alberta employers no longer need fret about giving reasons for terminating employees without cause.

Further, in light of *Styles*, it appears that, in Alberta, discretionary powers under contracts are powers fairly bargained for between the parties, such that the party with the discretion may exercise such power in its favour and to the other party’s detriment. In contrast, *Fraser* indicates that Ontario courts may undertake an examination of an employer’s reasons for exercising its discretion in a particular manner in order to ensure that such discretion is exercised reasonably. In addition, in Ontario, incentive plans must provide for benefits that extend through the statutory notice period. In any event, employers would be wise to revisit their incentive plans, stock option plans and bonus plans and tighten up their language in order to minimize the risk that they are interpreted unfavourably by a court or arbitrator.

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