



Forfeiture-on-resignation provision in long-term incentive plan not a restraint of trade

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Is a “forfeiture-on-resignation provision” in a long-term incentive plan an unreasonable restraint of trade? The answer is “No”, according to a recent decision of the Ontario Superior Court of Justice in [Levinsky v. The Toronto-Dominion Bank and TD Securities Inc.](#)

Blair Levinsky worked for the TD Bank (TD) in its investment banking group for 11 years. He was promoted to VP in 2002 and commenced participation in TD’s Long Term Compensation Plan (LTCP), under which he was granted a specified number of restricted share units (RSUs). The RSUs matured and became payable in cash 3 years after their date of grant. Section 6.5 of the LTCP provided that “A Participant’s entitlement to a particular award will be forfeited without notice by the Bank if the Participant resigns from service prior to the maturity date of such award”. When Levinsky resigned in 2010 to start his own hedge fund, he had a number of unmatured RSUs that had been granted to him under the LTCP in 2007, 2008 and 2009, and which had a value of approximately \$1,600,000. Levinsky forfeited the unmatured RSUs upon his resignation, and he sued TD for payment arguing that section 6.5 of the LTCP was unenforceable as an unreasonable restraint of trade.

Under the terms of the LTCP, TD granted awards of RSUs to participants at the end of a year. The awards were payable in cash based on the TD share price at the time of maturity. The LTCP provided that the participant had to remain a TD employee until the date of maturity and meet other vesting requirements to receive the cash payment equal to the redemption value of the awards. The “Participation Agreements” signed by Levinsky for 2005 and 2006 contained a “check box” requiring him to initial and acknowledge that he was aware of the forfeiture clause and that he has read and understood the LTCP provisions in their entirety. Levinsky checked the box and signed the Participation Agreements. (The Participation Agreements for 2007-2009, which were completed online, contained similar acknowledgments.)

The central issue was whether the forfeiture-on-resignation provision constituted an unreasonable restraint of trade, which in turn required Levinsky to demonstrate that the provision was in restraint of trade. The Court held that the forfeiture clause was not a restraint of trade as it was neutral regarding what Levinsky did after termination of employment with TD. Relying on the Ontario Court of Appeal decision in [Inglis v. The Great West Life Assurance Co.](#), the Court viewed such clauses as attaching a contingency to the entitlement to future income, but not a forfeiture of a vested right.

The Court articulated the following principles to be applied in an examination as to whether a requirement to remain in service to receive deferred compensation is a restraint of trade:

1. The court must assess whether the clause ties the forfeiture of compensation to the termination of employment or whether it ties it to the employee's post-employment conduct. Where the forfeiture results simply from the cessation of the employee's service, the clause would not operate in restraint of trade as it does not fetter the employee's ability to choose where he or she wants to work next; and
2. Even if the forfeiture results simply from the termination of employment, the court must examine determine whether the deferred compensation has already vested in the employee prior to termination, and if so whether or not forfeiture provision constitutes a penalty .

In the view of the Court, the forfeiture in question resulted simply from the cessation of the Levinsky's service and section 6.5 of the LTCP did not restrict him from engaging in any particular post-employment commercial activity. In short, the entitlements under the LTCP were dependent on the continuation of services and were a form of loyalty incentive, not a restraint of trade. Further, section 6.5 did not operate to take away vested rights of benefits from an employee, and it was therefore a binding and enforceable term of the contract of employment.

Commentary

This case demonstrates that courts will consider carefully drafted deferred compensation plans with forfeiture provisions to be enforceable programs with valid business objectives. In determining whether forfeiture provisions in deferred compensation plans constitute a restraint of trade, the courts draw a distinction between a benefit subject to a contingency and a forfeiture of a vested right. Forfeiture provisions tied to continuation of employment will generally be enforceable. Employers with deferred compensation plans containing forfeiture provisions should ensure that the payment is conditional on continuation of employment and nothing more. It is also noteworthy in this case that the employer required participants to initial a "tick box" annually to indicate the participant has read and understood the terms of the plan, including the forfeiture clause. Annual "sign-on" procedures, particularly where they draw attention to the forfeiture provisions, enhance the enforceability of forfeiture clauses in such plans and are recommended wherever appropriate.

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