



Recent decisions on Long Term Incentive Plans create uncertainty

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2015 and 2016 yielded a number of decisions dealing with long term incentive plans (LTIPs) and bonus plans, specifically on the question of whether or not a terminated employee is entitled to receive a bonus for the notice period or continued vesting of LTIP grants, as the case may be.

Back in 1999, employers learned a hard lesson when *Veer v Dover Corp.* was decided by the Ontario Court of Appeal. There, an employee successfully argued that because the employer's stock option plan did not explicitly state that he was not entitled to continued vesting for the notice period he was entitled to such vesting. In response, employers revised their plans to make it clear that once the employee was no longer an active employee, vesting would cease.

16 years later, it seems that these efforts may be starting to wear thin.

Absent clear contractual language, the general rule is that an employee terminated without cause is entitled to receive all compensation that they would have received throughout the notice period had their employment not been terminated. Knowing this, employers set out to craft bonus plans, stock option plans and LTIPs to achieve the desired outcome in the event that an employee's employment is terminated for any reason, whether by resignation, for cause, without cause, by death, etc.

Shifting Ground in Alberta

One recent decision in Alberta appears to undermine employers' efforts to ensure that terminated employees do not receive continued benefits under LTIPs.

In *Styles v Alberta Investment Management Corporation*, the Alberta Court of Queen's Bench ruled that an employee was owed more than \$400,000 under an LTIP after he was terminated without cause and denied payment of several LTIP 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 employer argued that the LTIP required that the employee must have been actively employed by the employer in order to be eligible to receive any payment, and if the employee was not actively employed, payment could be forfeited at the employer's option. Relying on the reasoning of the Supreme Court of Canada in *Bhasin v Hrynew*, Justice Yungwirth rejected the employer's argument. As discussed in an earlier [blog](#), in *Bhasin*, the Court articulated that parties to a contract must perform their contractual duties honestly and reasonably, and not capriciously or arbitrarily. Critically, in *Styles*, the Court extended

this reasoning to an employer's exercise of discretion, finding that contract law imposed a minimum standard as to the reasonable exercise of such discretion.

The Court concluded that the acceptance of a grant by the employee crystallized into a right to receive such grant at the end of the four year term. Following from this, the Court concluded that in determining whether or not to terminate Mr. Styles, the employer also had to consider whether or not to make any LTIP payments to Mr. Styles. Accordingly, the employer was required to exercise its discretion in a manner that was fair and honest, and not capricious or arbitrary. As part of this requirement, the employer had to consider the legitimate interests of the employee. Mr. Styles' apparently impeccable employment record, coupled with the employer's failure to provide reasons for Mr. Styles' termination, led the Court to conclude that it would undermine the "legitimate interests" of Mr. Styles if he were not awarded some payments under the LTIP. It was considered to be unfair, unreasonable and arbitrary for the employer to take the benefit of Mr. Styles' work while depriving him of earned benefits which had accrued. However, the Court indicated that the result would have been different if there had been no employee-earned benefits, the receipt of which were dependent upon the employee's continued employment.

The employer also argued that the LTIP contained an "entire agreement" clause, which displaced any implied duty upon it to act in good faith. However, the Court reiterated that contracting parties may not exclude or contract out of the implied duty of good faith, such as by way of an "entire agreement" clause.

In the result, the Court awarded Mr. Styles payments under the LTIP for each grant, discounted for their stage in their respective four year terms, which would have been paid throughout the reasonable notice period.

A question that arises from *Styles* is whether the Court conflated the acceptance of grants under the LTIP with the right to actually receive payments under the LTIP. The Court implies that once awarded for investment purposes, a right to payment was earned. It seems that the Court gave very little (if any) weight to the unambiguous language of the LTIP whereby acceptance only created a contingent right to payment, dependent upon vesting occurring four years from the date of acceptance and the employee's active employment.

Styles has been appealed and is set to be argued November 3, 2016. The Canadian Association of Counsel to Employers were **recently denied intervenor status** in the matter on the basis that the Court of Appeal was not persuaded that they had a unique or fresh perspective to add to the appeal.

Ontario

As described in more detail in our previous **post**, the Ontario Court of Appeal has also recently shown resistance to excluding incentive compensation from employees' entitlements upon termination without cause. In both ***Lin v OTPPB (Lin)*** and ***Paquette v TeraGo Networks Inc. (Paquette)***, Ontario's Court of Appeal held that an employee's right to compensation for bonuses that would have been paid during the employee's notice period following a termination without cause may not be avoided simply by the inclusion of contractual language stipulating that the employee be "actively employed" on the date a bonus is paid.

However, prior to the Ontario Court of Appeal's considerations of *Lin* and *Paquette*, Ontario's Superior Court of Justice considered a similar issue in ***Kielb v National Money Mart Company (Kielb)***. In contrast to *Lin* and *Paquette*, the Superior Court in *Kielb* held that an unambiguous limitation clause was sufficient to restrict the payment of bonuses during an employee's notice period upon termination without cause. Despite the Superior Court acknowledging that the provisions were harsh, it concluded that harshness alone does not make a provision invalid where both parties have agreed to it. While this decision is somewhat difficult to reconcile with *Lin* and *Paquette*, in *Kielb*, the employee was a sophisticated party (a

lawyer) who, the Superior Court noted, had participated in the negotiation of his employment agreement and had, according to the Superior Court, been given sufficient time to obtain independent legal advice.

The Ontario decisions seem to suggest that an employee may waive his or her right to damages in lieu of a bonus payment during the employee's notice period, however, limited guidance has been provided as to what is required to effectively do so.

Given the mounting uncertainty, it seems likely that either *Styles* or one of the Ontario decisions could eventually find their way before the Supreme Court of Canada to provide some much needed clarity.

Guidance for Employers

Styles illustrates the clear conflict between the reasonable exercise of an employer's discretionary contractual powers and the right of an employer to determine its workforce. Additionally, it suggests that the courts may be more active in examining employers' decisions that involve discretionary payments. *Styles* also suggests that it may be advisable for employers to provide reasons upon the termination of an employee without cause, so as to reduce the risk of a related discretionary decision being later found to be arbitrary and unfair (i.e., to demonstrate that their discretion was exercised in good faith and based on say, the poor performance of the employee, etc.).

Employers should be mindful of *Styles* when drafting employment contracts or other documents that contain discretionary elements, such as incentive plans, stock option plans and bonus plans. Care should be given to tightening up the language in incentive plans in order to provide further contours to what is an employee's "legitimate interest". Unambiguous limitation clauses should also be included which, in addition to requiring employees to be actively employed at the time compensation is considered to vest, also should make it clear that no benefit accrues or is earned until the time of vesting. Employers should also consider including language that clearly waives the employee's right to common law damages for any bonuses that would have been received during the reasonable notice period.

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