CASE IN POINT: REASONABLE NOTICE

A reasonable notice bonus

Supreme Court clarifies test for bonus damages and addresses employer obligations of good faith in Nova Scotia case

BACKGROUND

Subject to contractual restrictions, an employer is required to provide employees with reasonable notice of termination. Failing that, or in the event of a constructive dismissal, an employee may sue to recover the compensation that would have been paid during the period of reasonable notice. In many cases, the question of whether an employee is entitled to certain bonus payments has been argued over. The Supreme Court of Canada recently clarified how bonuses should be treated in relation to reasonable notice entitlements, along with the duty of good faith on both sides.

BY RISHI BANDHU

IN *Matthews v. Ocean Nutrition Canada Ltd.*, the Supreme Court of Canada clarified the legal principles applicable to a dismissed employee's entitlement to bonus money during the reasonable notice period. Secondly, the court addressed the nature of an employer's obligations of honesty and good faith, signalling that these duties will continue to evolve.

David Matthews, a chemist and senior manager, was a valuable contributor to Ocean Nutrition's business from the commencement of employment in 1997. In 2007, Ocean hired a new chief operating officer who did not like Matthews. His animosity resulted in a four-year "campaign" to marginalize Matthews. He eroded his responsibilities and lied to him about his future in the company. In June 2011, as a result of Ocean's conduct, Matthews resigned to accept employment with a new employer.

Thirteen months later, Ocean was sold for $540 million. Had Matthews remained employed by Ocean, he would have been entitled to a $1-million bonus under Ocean's Long Term Incentive Plan (LTIP).

Matthews brought an action for constructive dismissal. He claimed damages for the compensation he would have received during the reasonable notice period owed to him, including the LTIP bonus, less mitigation income. He sought a declaration that Ocean acted contrary to its contractual "duty of good faith" and punitive damages in relation to that alleged breach.

Lower court decisions

At trial, Matthews successfully proved he was constructively dismissed. The erosion of his responsibilities and Ocean's marginalizing course of conduct satisfied the test for constructive dismissal, established in *Potter v. New Brunswick Legal Aid Services Commission*. He was entitled to a reasonable notice period of 15 months. Since Ocean's sale fell within the reasonable notice period, Matthews was awarded the value of the LTIP bonus.

"Bad faith" damages were not awarded, despite the trial judge's findings of dishonest conduct by Ocean. This was due, in part, to Matthews' failure to lead evidence of mental distress in relation to bad-faith conduct. Further, the trial judge found that Ocean's conduct was not designed to avoid the LTIP bonus. Punitive damages were, therefore, inappropriate, said the trial judge.

Nova Scotia's Court of Appeal upheld the finding of constructive dismissal but disagreed that Matthews was entitled to the bonus. According to the court, the LTIP clearly foreclosed any entitlement to the bonus the moment Matthews left the company. Further, the LTIP was clear that it had no value for the purpose of calculating "severance."

Supreme Court decision

In a unanimous decision, the Supreme Court overturned the Nova Scotia Court of Appeal.

The top court did not reconsider whether Matthews was constructively dismissed or his entitlement to reasonable notice. The million-dollar question, literally, was his entitlement to the LTIP bonus during the 15-month notice period and the legal basis for awarding it. Matthews' counsel asserted that his entitlement flowed either from Ocean's breach of its obligation to provide reasonable notice of termination or its bad-faith conduct that forced him out of the business.

Reasonable notice

To determine whether an employee is entitled to bonus compensation during a reasonable notice period, the following test applies:

- If reasonable notice was provided, would the employee have earned the bonus?
- Are there contractual terms that unambiguously remove the right to receive the bonus during the notice period?

The answer to the first question was yes. Had Matthews been provided 15 months' reasonable notice, he would have been employed by Ocean on the date of the sale and entitled to the LTIP bonus.

On the second question, the Supreme Court overturned the Court of Appeal and answered no.

The LTIP contained two potential restrictions to prevent recovery of the bonus during the reasonable notice period. First, the plan required Matthews to be a "full time employee" on the date of the sale. Second, the plan provided that the LTIP bonus and its future value could not be taken into account for the purpose of calculating severance entitlements.

The court held that neither restriction prevented Matthews from recovering the LTIP bonus.

The fact that Matthews was not entitled to the LTIP itself because his employment terminated before it crystallized was irrelevant. What mattered was that he was entitled to the value of the LTIP as damages because it represented a foreseeable loss based on the failure to provide reasonable notice. To deny Matthews the LTIP incentive, Ocean needed to clearly and unambiguously specify in the contract that the bonus would not form part of his entitlement to compensation during the reasonable notice period. It did not do so.

The contractual provision providing that the LTIP bonus had no value for the purpose of calculating Matthews' severance entitlement also did not aid Ocean. Although "severance" is often used interchangeably with "payment in lieu of notice," the terms are, in law, technically distinct. Severance is a statutory concept intended to compensate employees with a lump-sum payment for long service. Reasonable notice, while encompassing severance obligations, requires employers to provide appropriate notice of termination while continuing all forms of compensation during the notice period that are not expressly excluded by contract (subject to statutory minimum requirements). As noted, the incentive plan in question did not validly exclude the LTIP bonus from Matthews' entitlement to reasonable notice.

In the end, based on established principles of wrongful dismissal, Matthews was entitled to the LTIP bonus that fell within the period of his reasonable notice entitlement.

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Good faith

The Supreme Court confirmed that an employer has a "duty of honest performance" in discharging contractual obligations, meaning it cannot "lie to" or "knowingly mislead" employees. Further, employers must act in good faith in the manner of dismissal, which is not limited to the moment of dismissal and can include conduct over an extended period of time leading up to a constructive dismissal.

Matthews argued that he was entitled to the LTIP bonus because it was a foreseeable loss, which flowed from Ocean's dishonest conduct, in breach of its duty of honesty, over the course of four years. Ultimately, though, the court opted to ground the bonus entitlement in reasonable notice principles, not good faith. The trial judge did not have the benefit of the Supreme Court's decision in *Bhasin v. Hrynew* establishing the duty of honest performance. Further, the evidentiary record concerning the effects of Ocean's conduct on Matthews was deficient.

By declining to apply principles of good faith to the facts, the court stopped short of declaring that employers are subject to a generalized duty of good faith performance that animates the entire employment relationship. Nevertheless, it acknowledged that reasonable notice damages do not adequately address the "non-monetary benefit" that employees derive from the employment relationship and which can be "wrongly taken from employees if, at dismissal, they are lied to or misled as to the reasons for termination."

With that recognition, the top court's decision nudges the common law toward expanded employer obligations of good faith, stating: "It might be that…a duty of faith will one day bind the employer based on a mutual obligation of loyalty in a non-fiduciary sense during the life of the employment contract, owed reciprocally by both the employer and employee," but leaves the debate open to consider on another set of facts.

Takeaways for employers

The *Matthews* decision provides two key lessons for employers.

First, employment agreements must use clear and unequivocal language to restrict entitlement to incentive payments during a reasonable notice period. A requirement of active employment at the time of bonus entitlement will not suffice. This is because the law deems employment terminated at the end of the reasonable notice period.

Second, obligations of good faith during the course of an employment relationship are evolving. Courts will continue to address, with potentially more expansive remedies, employer conduct that is dishonest, insensitive, misleading or unduly harsh leading up to termination.

For more information, see:

- *Matthews v. Ocean Nutrition Canada Ltd.*, 2020 SCC 26 (S.C.C.).
- *Bhasin v. Hrynew*, 2014 SCC 71 (S.C.C.).
- *Potter v. New Brunswick Legal Aid Services Commission*, 2015 SCC 10 (S.C.C.).

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