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Bonuses & Bad Faith: The Supreme Court Clarifies Terminated Employee's Entitlement To \$1M Incentive Payment

Are terminated employees entitled to the payout of bonuses during their reasonable notice period? And should this assessment be informed or affected by an employer's bad faith or dishonest conduct that led to an employee's termination or constructive dismissal? These were some of the questions before the Supreme Court of Canada in the eagerly anticipated decision in *Matthews v Ocean Nutrition Canada Ltd.* The case offered a unique opportunity for the Court to comment on the contractual duty of good faith outlined in *Bhasin v Hrynew* and its potential effects on employment relationships and exclusion clauses.

Ultimately, the Supreme Court of Canada did find that terminated employees are entitled to their bonuses where (a) the payment would have been made during the reasonable notice period and (b) absent any unambiguous contractual term that would limit the employees' common law right to a reasonable notice period. In coming to this decision, the Supreme Court of Canada used employment law principles and noted that it was unnecessary "perhaps even unwise given the method on which *Bhasin* rests" to resolve the allegations of bad faith/dishonest treatment on the basis of reasonable notice.

Background

The Appellant, David Matthews is a chemist who previously worked in several senior management positions since 1997 with the Respondent, Ocean Nutrition Canada Limited ("Ocean"). Ocean manufactures omega-3 fish oil for commercial sale, and Mr. Matthews was critical to this manufacturing process. As part of his employment, Mr. Matthews was a member of Ocean's long term incentive plan (the "LTIP"), which in the event of the sale of Ocean, significant monies would be paid out to Mr. Matthews if he was an employee at the time of the sale. The LTIP purported to exclude payment if Mr. Matthews resigned or was terminated.

While Mr. Matthews had a good relationship with the company

since 1997, everything changed in 2007 upon the hiring of Daniel Emond as Chief Operating Officer. Mr. Emond did not like Mr. Matthews and began what the trial judge characterized as a “campaign” to marginalize Mr. Matthews in the company, including lying to Mr. Matthews and other management about Mr. Matthews’ status and prospects with the company. Eventually, Mr. Matthews left the company in 2011 and alleged that he was constructively dismissed. About 13 months later, Ocean was sold for \$540 million.

At trial, the Nova Scotia Supreme Court found that Mr. Matthews was constructively dismissed, the reasonable notice period was 15 months, and Mr. Matthews was entitled to approximately \$1 million for the loss of the LTIP payment (*i.e.*, the amount he would have received during the notice period less mitigation payments).

The Nova Scotia Court of Appeal upheld the trial judgment, but on a 2-1 split decision, held that Mr. Matthews was excluded from receiving the LTIP payments by virtue of the exclusion clause in the LTIP, which stated that the LTIP could not be used for severance purposes. The dissent held that Mr. Matthews was entitled to the LTIP payments because there was a common law duty of honesty in the LTIP contract and the employment contract, which were breached by Mr. Emond’s conduct.

The Decision

The Supreme Court of Canada allowed the appeal and held that Mr. Matthews was entitled to the full LTIP payments (less mitigation payments). In reaching this conclusion, the Court affirmed that terminated employees are entitled to bonus payments, where:

- (a) the employee would have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period, and
- (b) the terms of the employment contract or bonus plan do not unambiguously take away or limit that common law right.

The Court also clarified that it is not necessary to consider if the bonus payment is “integral” to an employee’s compensation if it is clear that the employee would have been paid the bonus during the reasonable notice period. The “integral” test assists in answering the question of what the employee would have been paid during the reasonable notice period. For example, it would be applicable if the bonus was discretionary.

In this case, the LTIP did not unambiguously limit Mr.

Matthews' common law right to reasonable notice. First, the Court held that language requiring Mr. Matthews to be "full-time" or "actively employed" did not remove his common law right to damages, as if he had been given proper notice, he would have continued to be employed through the reasonable notice period. Second, the Court held that the clause purporting to remove his common law right to damages if he resigns or is terminated with or without cause, was insufficient. Here, Mr. Matthews suffered an *unlawful* termination since he was constructively dismissed without notice. Third, the Court held that the clause preventing Mr. Matthews from seeking the bonus as part of his severance was also inapplicable, as severance and damages are distinct legal concepts.

The Supreme Court of Canada also took great pains to clarify that at common law, an employee has an implied contractual right to reasonable notice on termination without cause and *not* an implied contractual right to pay in lieu of notice.

While the Court recognized that there is a measure of uncertainty as to the impact of *Bhasin* on employment law more generally, the Court did not utilize principles of good faith in determining Mr. Matthews' entitlement to bonus payments. The Court held that a contractual breach of good faith rests on a wholly distinct basis from that relating to the failure to provide reasonable notice. Instead, employees can be compensated for employers' dishonesty, where said dishonesty causes mental distress. The Court did, however, recognize that an employer's dishonest conduct is relevant to the performance of the employment contract prior to the moment of termination and can form a component of the analysis on the manner of dismissal in wrongful dismissal cases.

Interestingly, the Court did note that there may be room for a duty of good faith that could bind an 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. However, the Court declined to recognize one at this time in the context of a constructive dismissal case.

Implications

The key take-away from this case is the importance of crafting careful termination clauses. Unless the termination clause is unambiguous and excludes an employee's common law right to reasonable notice, it will not be enforceable. As was seen here, even language that purports to prevent bonus payments from being part of a severance package will not be enough as severance at law is not the same as damages arising from a failure to provide a reasonable notice period on termination.

without cause or constructive dismissal.

While the Court ultimately did not impose an additional duty of good faith in the employee-employer relationship, it did leave the door open for courts to recognize such a duty where employees are mistreated, but choose not to leave their job. It seems likely that these issues will continue to be explored by courts (including appellate courts) in future cases.