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Contract, termination and compensation updates

Scott Sweatman, Partner, Vancouver
Cristina Wendel, Partner, Edmonton
Taylor Buckley, Senior Associate, Vancouver
Allison W. Buchanan, Associate, Toronto

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DENTONS WEBINAR SERIES
COVID-19 - LEGAL UPDATE
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Meet our presenters



Scott Sweatman
Partner, Vancouver
+1 604 443 7114
scott.sweatman@dentons.com



Taylor Buckley
Senior Associate, Vancouver
+1 604 648 6522
taylor.buckley@dentons.com



Cristina Wendel
Partner, Edmonton
+1 780 423 7353
cristina.wendel@dentons.com



Allison Buchanan
Associate, Toronto
D+1 416 863 4746
allison.buchanan@dentons.com

Frustration of Employment Contracts in the COVID-19 World

Cristina Wendel, Partner, Edmonton

Frustration – legislation

- *Employment Standards Code* (Alberta)

- Section 55(2)(h) of the Code:

55(2) Termination notice is not required

- (h) if the contract of employment is or has become impossible for the employer to perform by reason of unforeseeable or unpreventable causes beyond the control of the employer.

- Examples:

- Incarceration;
- Extended sick leave;
- Employee working for a competitor; and
- Fire that destroyed the workplace and equipment.

Frustration – legislation

- But not:
 - Insolvency;
 - Downsizing; or
 - Plant closure.
- COVID-19:
 - Does job loss due to a global pandemic constitute frustration under the Code?

Frustration – common law

- Geoffrey England: “the doctrine of frustration of contract is concerned with who should bear the risk of unforeseen events.”
- At common law, the doctrine of frustration is a contract law principle that occurs when a change of circumstances arises, without the fault of any party, and for which the parties made no provision in the contract, that renders performance of the contract “a thing radically different from that which was undertaken by the contract.”
- When a contract is frustrated, the contract is at an end and the parties are relieved of their obligations under the contract.
- The doctrine of frustration applies to employment contracts.
 - Typically as a defence to a wrongful dismissal claim.

Frustration – common law

- Where an employment contract is frustrated, the employment relationship comes to an end and the employer is not required to provide termination notice or payment in lieu.
- Considerations to determine if an event constitutes frustration:
 - Whether the event is something that strikes at the very basis of the contract. It is not enough that the event has made the contract a more difficult or expensive proposition for the employer.
 - The event must not have been caused through the fault of the employer.
 - The employment contract must not have addressed the possibility that the event might occur or have provided for its consequences.

Frustration – common law

- If the event relied on was reasonably foreseeable by the employer, it will not be considered frustration. For example:
 - Strikes or labour disruptions;
 - In some instances, disability where the employment agreement provides for long term disability benefits.
- Similarly, if the event was self-induced by the employer, it cannot be relied on as a basis for frustration. For example:
 - Employer's voluntary assignment into bankruptcy;
 - Change in the law where the employer is the government.

Frustration – common law

- Examples of frustration at common law:
 - Supervening illegality - a legislative change or administrative decision that makes further performance of the agreement illegal.
 - Employee's loss of status or credentials.
 - Act of god / natural disaster.
 - Illness or injury where there is no reasonable prospect that the employee will be able to return to work in the foreseeable future.

Frustration – common law

- *Smith v. Tamberlyn (Alberta) Limited*, 1979 CanLII 1036 (ABQB):

Impossibility of performance cannot be alleged, however, where performance is merely more onerous or less profitable than the parties had hoped would be the case. An agreement of personal service is not impossible to perform because business has fallen 30 per cent, even if the fall is permanent. It seems hardly necessary to expand on that point. No authority was or could be cited, in my opinion, for the proposition that such a circumstance amounts to an impossibility in the performance of a contract.

- This conclusion may not apply where the employer is a business that has been ordered to close and remain closed.

Terminations during Covid-19: considerations and obligations

Allison W. Buchanan,
Associate, Toronto

Can you dismiss an employee during the pandemic?

- Human Rights
 - Disability
 - Includes transient illnesses such as COVID-19
 - Family Status
 - Protects parent/child relationships, including non-biological parents
 - Raises issues with childcare needs, including increased issues due to school closures and working from home
 - Ethnicity
 - Race, ancestry, place of origin, colour, ethnic origin

Notice periods

- Impact of COVID-19 on Notice Periods
 - *George v Laurentian Bank Securities Inc*, 2020 ONSC 5415
 - 58 year old Vice President Equity Trading, employed for 5 months and awarded 2 months reasonable notice.
 - *Rothenberg v Rogers Media Inc.*, 2020 ONSC 5853
 - 73 year old broadcaster, employed for almost 20 years and awarded 21 months of reasonable notice.

Notice periods, cont.

- Is the economic hardship of the Employer a factor?
 - The Ontario Court of Appeal says “no” in *Michela v St. Thomas of Villanova Catholic School*, 2015 ONCA 801.
 - “It is important to emphasize, then, that an employer’s poor economic circumstances do not justify a reduction of the notice period to which an employee is otherwise entitled...”
 - However, other jurisdictions have indicated it remains a relevant factor.
 - *Freeman v PetroFrontier Corporation*, 2017 ABQB 340: “the state of the economy may in any given case militate either for or against an extended notice period. In some cases, it may indeed be unrealistic (and unfair) to burden an employer with the same notice period in a depressed economy as it would be in a time of prosperity.”

Incentive compensation

Considerations for the Covid-19 workplace

Taylor Buckley, Senior Associate,
Vancouver

Incentive compensation for the Covid-19 workplace

Overview of incentive compensation

- Non-salary/wage compensation, often deferred or discretionary, in the form of cash- or equity-based payments.
 - Often incorporated into long- or short-term incentive plans (LTIPs and STIPs).
- Examples:
 - Discretionary cash bonuses.
 - Performance cash bonuses.
 - Share purchase rights.
 - Stock options.
 - Share appreciation rights.
 - Performance share units.
 - Restricted share units.

Incentive compensation for the Covid-19 workplace

Purpose of incentive plans

- Attract and retain key employees.
- Align employee behaviour with company goals.
 - Tracking of key performance indicators by company and employees.
- Compensate employees in a tax-efficient way.
 - Beware *Income Tax Act* rules about salary deferral arrangements.
- Allow for fluctuations in compensation in line with company performance
 - *i.e.*, variable compensation.
 - Reducing elements of core compensation (e.g., salary or wage rate) creates constructive dismissal risk.

Incentive compensation for the Covid-19 workplace

Common (but not universal) elements of incentive compensation

- Defined performance period.
- Target award, with the final award based on achieving objectives during the plan year.
 - Achievements may be discretionary, objective or a combination of the two.
 - Achievements may be individual or company-wide or a combination of the two.
- Award formula.
 - For non-discretionary awards, employees should know the formula they are measured against
- Vesting schedule.
- Board discretion for participation and award grants.
- Plan text with individual grant agreements.
 - Individual grant agreements are more common for plans that include a formula or vesting schedule.

Incentive compensation for the Covid-19 workplace

How does Covid-19 change things?

- From a strictly legal perspective, it does not, but practical effects can create legal and HR risks.
- The pandemic's effects have been a mixed bag for companies; awards may be much smaller or larger than expected.
 - Management awards may not reflect the experience of lower-level workers during the pandemic.
 - What are the optics of large awards during this time?
- Foregoing or reduce awards may create a retention issue or legal challenges.
 - Even if based on a formula, employees may see small (or nil) awards as a take-back by their employer.
 - Employees may see poor financial performance as unrelated to their level of work and stress.
- Changes in short- and long-term company objectives in response to the pandemic may change the appropriateness of an incentive plan's design.

Incentive compensation for the Covid-19 workplace

How should employers respond?

- There is no one-size-fits-all approach for all companies.
 - Companies need to balance retention and performance.
- Review plans to ensure that incentives align with company objectives is helpful as the commercial reality evolves.
- Review plans to ensure sufficient legal protections are in place.
 - Grant agreements can often be amended on a go-forward basis without requiring a plan change.
- Are there options for temporary deferred-compensation arrangements to weather the storm?
 - The *Income Tax Act* permits payments that are not designed for the purpose of deferring *tax* to be made within three years of being earned without triggering the salary deferral rules.
- How will reductions/changes be messaged? How will they be received?
- Give notice of future changes where possible.

Incentive compensation for the Covid-19 workplace

Incentive plans and terminated employees - *Matthews v Ocean Nutrition Canada Ltd.*, 2020 SCC 26

- Recent Supreme Court of Canada decision confirming the approach to damages for incentive plan payments for terminated employees.
- The SCC awarded a terminated employee more than \$1 million in compensation for the loss of a bonus he would have received under an LTIP, but which did not become payable until 13 months after the employee's termination.
 - The LTIP included a change of control award if the employee was employed on the date of the sale.
 - The employee was constructively dismissed and was awarded a 15-month notice period.
 - The sale occurred 13 months after the employee's termination.

Incentive compensation for the Covid-19 workplace

Incentive plans and terminated employees - *Matthews* (cont'd)

- Basic damages principles:
 - Terminated employees are entitled to compensation for all losses arising from the failure to give proper notice.
 - Damages should place the employee in the same financial position as if notice had been given.
 - Common law entitlements can be ousted by contract, if the contract is unambiguous and meets minimum standards.
- The Court approved a two-part test for determining whether damages for wrongful dismissal includes bonus payments and other benefits.
 - First, would the employee have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period? **In this case, YES.**
 - Second, if so, do the terms of the employment contract or bonus plan unambiguously take away or limit that common law right? **In this case, NO.**
- A note about discretionary awards: a court will assess whether a discretionary award would have been granted on the basis of whether it is an integral part of compensation.

Incentive compensation for the Covid-19 workplace

Incentive plans and terminated employees - *Matthews* (cont'd)

- Because the LTIP was a unilateral contract, clauses excluding or limiting liability should be strictly construed.
 - Language requiring an employee to be “full-time” or “active” at vesting does not remove common law rights to damages.
 - Language purporting to remove common law rights to damages upon termination “with or without cause” sufficient.
- So what can be done? Is any language good enough?
 - Courts will closely scrutinize termination language in incentive contracts, but it is possible to limit awards → revisit plan texts.
 - Consider the upper and lower limits of awards, generally.
 - The facts of this case were problematic for the employer; good faith was in question.

Questions?



Thank you



Scott Sweatman
Partner, Vancouver
+1 604 443 7114
scott.sweatman@dentons.com



Taylor Buckley
Senior Associate, Vancouver
+1 604 648 6522
taylor.buckley@dentons.com



Cristina Wendel
Partner, Edmonton
+1 780 423 7353
cristina.wendel@dentons.com



Allison Buchanan
Associate, Toronto
D+1 416 863 4746
allison.buchanan@dentons.com

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