OCTOBER 2001

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Employment Notes

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WHAT HAPPENS TO STOCK OPTIONS AND SHARE PURCHASE PLANS ON TERMINATION OF EMPLOYMENT?

D. Barry Prentice

As anyone who deals with executive compensation will tell you, incentive pay has become a significant element of remuneration. Incentive compensation may take many forms including commissions, bonuses, profit share, stock options, stock ownership, etc. The ability to attract high calibre personnel will very often be dependent upon how attractive the potential "upside" is, particularly in the area of options on company stock.

THE LEGAL STARTING POINT

Unless there is a valid specific agreement to the contrary, a contract of employment can only be terminated (without cause) upon reasonable notice. Ever since *Bardal v. The Globe & Mail*, it has been well established that a wrongfully dismissed employee (i.e. terminated without cause and without reasonable notice) is entitled to damages equal to the value of all forms of remuneration during the reasonable notice period. This is an important starting point and a basic principle for the analysis that will follow.

THE QUESTION

Given the fact that the primary obligation is to provide reasonable notice, the first question is what would the employee have received had the employer given reasonable notice? Clearly, this would include salary and benefits (or perhaps the value of those benefits). Logically, and to be consistent with *Bardal*, the employee should also be entitled to receive damages on account of the incentive compensation (e.g. on account of the exercise of stock options) that he or she would have received had the employer complied with its obligation to provide reasonable notice. In other words, the employee is entitled to be put into the same position as if reasonable notice had been given.

DOES THIS MEAN THAT OPTIONS REMAIN "ALIVE"?

The principle that all benefits are exercisable during the reasonable notice period logically includes the right to exercise any stock options which exist at the date of termination or which would have accrued during the notice period.

A number of cases have been decided on the basis of the employee's history in exercising options. In other words, if options are typically purchased, then the court will likely find the right to purchase options and thus award damages for the notice period and vice versa. This makes sense and is similar to the argument advanced with respect to bonus, i.e. if bonus is typically paid, it has become a contractual right and should be paid during the notice period.

Very often, however, stock options or share purchase plans provide for the options to vest over a period of time. Typically, the employee will be entitled to exercise a limited number of options on the anniversary dates of the grant. In addition, particularly if the employer is a private company, the plan will require the employee to sell his shares to the employer on termination. These agreements also usually provide that any unexercised or unvested options will lapse on termination or that the employee has a limited period to exercise them(typically 30 days) following termination.

EMPLOYMENT NOTES

"The court will look very carefully at the wording of any clause which purports to deny an employee a significant portion of the compensation to which he or she is otherwise entitled."

HOW DO OUR COURTS INTERPRET SUCH CLAUSES?

In the case of *Brock v. Mathews Group* the Ontario Court of Appeal held that the following clause was effective in terminating the options as of the actual date Brock ceased to be employed rather than at the end of the reasonable notice period:

> *in the event of an employee ceasing to be an employee… the option hereby granted shall forthwith cease and terminate…; provided that where the employee is dismissed by the corporation, the employee shall have 15 days from the date notice of dismissal is given in which to exercise the option…*

Generally speaking, of course, the parties to a contract are left to contract for themselves and the Court will not interfere. This approach was taken in *Brock*. Our courts have, however, adopted a supervisory responsibility over the employee/employer relationship. If the agreement purports to take away a right which the court would otherwise grant, the contractual language must be very clear and unambiguous. It may also have to pass a "fairness test". This is particularly the case where the incentive compensation is significant when compared to salary and where it has been regularly paid over a significant period.

Later cases have established that the result in *Brock* will be the exception rather than the rule. The court will look very carefully at the wording of any clause which purports to deny an employee a significant portion of the compensation to which he or she is otherwise entitled.

For example, in the case of *Veer v. Dover Corp.*, the Court of Appeal held that to be effective, any clause which purports to terminate the right to exercise options during the reasonable notice period must contain clear language to contradict this general principle. The Court distinguished *Brock* by focussing on the words "date notice of dismissal is given" and concluding that the parties intended the actual termination date to be the triggering event.

In December of 2000 the Ontario Court of Appeal had the opportunity to revisit its reasoning in *Veer* and deal with the following contractual language in a stock option plan:

> *If an optionee ceases to be employed by the Corporation otherwise than by reason of death or termination for cause, or if an optionee ceases to be a director other than by reason of death, removal or disqualification, any option or unexercised portion thereof held by such optionee at the effective date thereof may be exercised in whole or in part for a period of thirty (30) days thereafter.*

The Court held that this wording was different from that in *Brock* and could be read as contemplating a "lawful termination" and that the words "effective date" meant the date following the notice period (which the trial judge had assessed at 9.5 months). As a result, Gryba was entitled to damages equal to what he would have realized had he been permitted to exercise his options during the 9.5 month notice period. Moneta's application for leave to appeal this decision to the Supreme Court of Canada was dismissed on August 9, 2001.

Given the Court of Appeal reasoning in *Veer* and *Gryba* it will be up to the employer to draft very clear language if it is to deny the employee the benefit of exercising stock options during the notice period. ■

EMPLOYMENT NOTES

"The Court ruled that the employee could not receive both disability benefits and damages for wrongful dismissal over the same period of time."

DISABILITY BENEFITS & DAMAGES FOR WRONGFUL DISMISSAL

Kevin Robinson

The Ontario Court of Appeal has recently considered whether a terminated employee who receives disability benefits during a period of reasonable notice is entitled to both the disability payments and the damages for wrongful dismissal, or just one or the other.

The prevailing jurisprudence prior to this year was found in the Supreme Court of Canada decision in *Sylvester v. British Columbia*. In that case, the disability benefits were self-insured by the employer. The Court ruled that the employee could not receive both disability benefits and damages for wrongful dismissal over the same period of time. However, the Court did say that there may be cases in which an intention can be inferred that the employee and employer have agreed that the employee should receive both disability benefits and wrongful dismissal damages at the same time.

This issue has been the subject of two recent decisions of the Court of Appeal in *McNamara v. Alexander Centre Industries Ltd.* and *Sills v. Children's Aid Society of the City of Belleville.*

In *McNamara*, an employer had decided to terminate an employee with twenty-four years' seniority, who had progressed to the position of president of the corporation. The termination took place one week after the employee advised that he would be off work due to a medical condition. It is clear from the judgment that these circumstances coloured the Court's view as to the final determination. It proposed a hypothetical scenario whereby a reasonable employer and reasonable prospective employee had turned their minds, at the commencement of the employment relationship in 1971, to "what happens if [the employer] decides to fire McNamara the instant he becomes disabled." The Court determined that, in that circumstance, they would have agreed that he would receive both disability benefits and damages for wrongful dismissal. The major distinguishing factor between this case and *Sylvester* is that the disability benefits were funded by a third party insurance company.

In the *Sills* case, the Court was not faced with such extreme facts, however, it considered the same issue. The result was similar. The Court's reasoning focused on whether the employer should be relieved of paying damages for wrongful dismissal because the employee becomes disabled, and therefore, better off than if the employee was not disabled.

The important piece of evidence noted by the Court of Appeal in each of the *McNamara* and *Sills* was the evidence of both of the employees that they had accepted a lower annual salary in return for a benefit package. Therefore, the Court concluded that each of the employees were, in a manner of speaking, self-insuring against disability. The Court stated that the employer should not have a windfall because of the foresight and prudence of the employee in securing those benefits.

The decisions in *Sills* and *McNamara* do not create a "rule" whereby employees will necessarily be entitled to both damages for wrongful dismissal and disability benefits during a reasonable notice period. However, particularly where a disability benefit is provided by a third-party carrier, the reasonable intentions of the parties will be analyzed to determine whether disability benefits should be included or excluded in the calculation of any award for wrongful dismissal. ■

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EMPLOYMENT STANDARDS ACT, 2000

Elizabeth J. Forster

The *Employment Standards Act, 2000* came into force on September 4, 2001, and has already been amended by the *Government Efficiency Act*. Highlights of the *Employment Standards Act* were set out in our January, 2001 Employment Bulletin.

Regulations under the Act have now been prepared. For the most part, the Regulations are similar to the Regulations under the former legislation and the case law interpreting them. There are, however, several noteworthy changes including:

1. The penalties for breach of the Act have increased significantly. Some of them are as high as $1,000.00 per employee affected.

2. Employees in the retail sector who are hired after September 4, 2000, may not refuse to work on a Sunday if they agreed to work Sundays at the time of hire unless the reason for the refusal is based upon religious belief or observance.

3. The Regulations now contain special rules for the payment of commissioned automobile sales employees.

4. The Act now requires that the employer post and keep posted the following material in the workplace:

(i) A poster prepared by the Ministry called "What you should know about the Ontario Employment Standards Act".

(ii) Information about dispute resolution under the Act.

(iii) Information about enforcement and administration of the Act.

(iv) A description of how to obtain other information about the Act.

5. Employees may agree to average their hours over more than a 4-week period for the purpose of calculating overtime provided the consent of the Director of Employment Standards is obtained.

6. Employees may agree to work more than 60 hours per week provided the consent of the Director of Employment Standards is obtained.

A copy of the Regulations can be obtained from the Ministry of Labour's website at **http://www.gov.on.ca/lab/main.htm.**

Employment Notes is a publication of the Labour and Employment Law Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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