Avoid Constructive Dismissal Risks When Altering the Terms of Variable Pay Arrangements



Layoffs aren’t necessarily the only way let alone the best way to cut payroll costs. Imaginable alternatives to consider include variable pay arrangements under which employees receive smaller salaries with the promise of additional compensation if the company’s financial performance or economic value improves. Incentives may include bonuses, profit sharing, or stock options, to name just a few. Just recognize and steer clear of the legal pitfalls associated with variable pay arrangements, including the risk of liability for constructive dismissal.

The Liability Constructive Dismissal Pitfall

Whether set out in an employment contract, collective agreement, or company policy, employers must honour the terms of variable pay arrangements unless the employee agrees otherwise. Unilateral changes can lead to liability including for “constructive dismissal.” Because it goes to the very heart of the employment relationship, changing the terms of compensation unilaterally is the kind of practice that can lead to constructive dismissal claims—even if the change affects only the variable pay part of the compensation arrangement.

Example: Each year, an Alberta galvanizing company has paid a portion of company profits to employees, in addition to regular wages. One year, without warning, the company decides to issue company shares instead of cash bonuses. The company claims it can make unilateral changes because the profit-sharing plan is a company policy rather than a term of an employment contract. But the court disagrees and orders the employer to pay profits in cash to each employee. Switching from cash bonuses to stock shares substantially changed the essential terms of employment and amounted to constructive dismissal, the court rules [*Carabine v. Daam Galvanizing Inc*., 2000 ABPC 56 (CanLII)].

Manage Risk by Avoiding Unilateral Changes

Changing the terms of variable pay arrangements isn’t illegal, even if the changes are unfavorable to employees. What you can’t do is make those changes unilaterally.

Thus, in finding the company liable for constructive dismissal, the *Carabine* court said the employer should have communicated the changes to employees and gotten their input in restructuring the plan.

By the same token, you don’t have to offer new employees who haven’t yet signed an employment agreement the same exact terms that apply to current employees who are under contract. New employees start with a clean slate and you’re free to negotiate any variable pay arrangement you want. Of course, payroll ultimately has to process all the agreements. And the more variable pay arrangements you make, the more burden it places on payroll.