I'm Taking My Contract And Going To Court: Employers Must Consider Contractual Interests Of Dismissed Employees



It is commonly recognized that employers are obligated to act fairly and honestly with regards to performance of their contractual obligations. A recent decision of the Alberta Court of Queen's Bench has expanded this duty in the employment context.

In a recent trial the judge found that the duty to act honestly requires an employer to consider the contractual interests of its employees when determining what an employee is owed upon termination. In doing so, the trial judge awarded damages for incentive payments in a manner that goes far beyond the traditional approach.

Background

The employee's employment contract with Alberta Investment Management Corporation ("AIMCo") contained a without cause termination provision that entitled AIMCo to terminate his employment on one month's notice (or payment of base salary in lieu of notice) per full year of service, to a maximum of six months.

In addition to his base salary, the employee's contract also entitled him to participate in various incentive compensation programs, including AIMCo's Long Term Incentive Plan ("LTIP"). Under the LTIP, the employee was eligible to receive "discretionary" cash-based grants from AIMCo which would be subject to four year performance cycles. The grants were to be invested by AIMCo for the employee's benefit, and paid out on pre-determined maturity dates.

During his 3.5 years of employment, AIMCo "approved" LTIP grants to the employee in 2011, 2012 and 2013 (with maturity dates in 2015, 2016 and 2017, respectively).

In mid-2013, the employee was dismissed on a without cause basis. No reason for dismissal was provided as part of the evidence in the trial. In accordance with his contract, the employee received three months' base salary in lieu of notice. However, AIMCo did not provide any compensation in respect of the LTIP grants because the terms of the LTIP provided that the employee must be actively employed on the maturity date to receive payment. The employee subsequently sued AIMCo for the value of the grants and the action proceeded by way of summary motion.

Honesty, Fairness and Reasonableness

The Court started its analysis by acknowledging the general duty to act honestly in the performance of contractual obligations, including obligations that exist between employer and employee. It also recognized the long-standing principle that discretionary contractual powers must be exercised fairly and reasonably, and not in a manner that is capricious or arbitrary.

In *Styles*, the Court noted that the employee had consistently exceeded every performance target that was put to him by AIMCo. The LTIP grants awarded to him were in recognition of this exceptional performance and, notwithstanding the clear language of the grant agreements, the Court found that the grants became accrued rights that were no longer at the discretion of AIMCo.

The Court also made much of the fact that AIMCo provided no explanation for the employee's dismissal, other than to say that it was "without cause". In the Court's opinion, the timing of the employee's dismissal raised questions about whether his looming entitlement was an unwarranted factor in AIMCo's decision to terminate his employment – even though there was no evidence that AIMCo had actually acted in bad faith. Thus, the Court found that the decision to terminate and deny payment of the LTIP grants was "arbitrary".

The Court concluded that, by dismissing the employee in the manner that it did, AIMCo ultimately failed to consider the employee's legitimate contractual interest in the LTIP. In other words, AIMCo fell short of its duty to act honestly, fairly and reasonably.

As a result, the Court ordered AIMCo to pay the employee damages for his lost LTIP grants, almost to the full value *as if he had been employed through to the respective maturity dates*. This is a surprising award in that it seems to challenge the widely accepted notion that an employee's entitlements upon termination lapse at the end of the applicable notice period.

What Now?

For years, the courts have held that employers can dismiss employees without cause provided that they do so "in good faith and not for the special purpose of defeating the contract". Now, in the wake of *Styles*, the contract may not be sufficient protection if a trial judge is of the opinion that the termination was not performed honestly and fairly.

In order to try and avoid the same fate as AIMCo, employers should take care to carefully consider employees' contractual interests whenever contemplating dismissal. Employers are also well advised to provide clear and cogent reasons for following through with terminations whenever they will result in the loss of an entitlement, such as when "active employment" is a condition precedent to the payment of incentive compensation.

Above all, employers should always consider whether their potentially adverse decisions will be perceived as honest, fair and reasonable in the eyes of a third-party decision maker.

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