

Termination Agreements—Appeal Courts Get it Right Employers Must Pay What They Promised

Introduction

Courts now recognize that employers must pay departing executives the termination pay they said they would pay in a written employment agreement. This seems like an obvious, straight-forward and logical concept, not worthy of a newsletter.

However, until recently, employers sometimes used to subtract from the termination amounts owed to former executives under the employment agreement, the amounts earned by the former executive from new employment or self-employment throughout period of notice of termination stipulated in the agreement, unless expressly prohibited by the agreement. This often came as a surprise to departing executives who believed they were entitled to the ter-

mination amounts set out in their agreements, regardless of their future earnings.

This newsletter reviews the obligations of employers and executives on the termination of the employment relationship when there is a written employment agreement with and without express termination provisions.

Without a Termination Clause

Many employment agreements are silent on the obligations of employers and executives on the termination of the employment relationship. The lack of termination provisions arises for many reasons. Sometimes, employers and executives

These quarterly newsletters provide practical advice and current legal comments on executive compensation and compensation governance and disclosure. These newsletters will be of interest to directors, executives, lawyers and human resources professionals.



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From the Editor

The termination of an executive's employment can be a traumatic event for an executive, personally and professionally, especially considering the lengthy period of time it can take to find new employment at the executive level. Executives typically turn to their termination provisions in their employment agreements hoping they will at least have some measure of financial security while they look for new employment. Recently, the appeal courts in Ontario and Quebec have clarified how they will interpret the implied duty for executives to mitigate their wrongful dismissal damages in the context of express termination provisions. These decisions, reviewed in this newsletter, reinforce the continued willingness of the courts to endeavor to protect employees including executives, whom the courts have long recognized as a vulnerable group in society that rarely have bargaining power equal to their employers.

want the recruiting process to be a positive experience and are concerned that addressing termination provisions can “sour” the process. Other times, employers and executives are unable to agree on the termination provisions so they agree to remain silent on the issue in the employment agreement. Whatever the reason, their silence on the termination obligations does not equate to an ability to terminate an executive's employment without any obligations. Rather, when employment agreements are silent on the termination obligations, courts imply obligations on employers and executives.

On employers, courts imply an obligation to provide executives with “reasonable notice” of the termination of their employment without cause. The amount of notice of termination that is reasonable depends on various factors in each case, such as the executive's age, length of service, the managerial character of the executive's employment, the availability of similar employment at the time of termination and whether the executive was induced from his or her prior employer. Courts often award

executives periods of reasonable notice of termination ranging from 12 to 24 months, which recognizes the limited availability of alternate employment for executive level positions. Employers who breach their obligation to provide reasonable notice of the termination of an executive's employment are liable for the damages, commonly called wrongful dismissal damages. Typically, damages are determined based on the total compensation the executives would have earned during the notice period had they been provided reasonable notice of termination.

On executives, courts imply an obligation to mitigate their damages. The obligation to mitigate damages requires executives to seek and accept alternate employment during the reasonable notice period. An executive's earnings during the reasonable notice period, whether from new employment or self-employment, are then subtracted from the damages owed by the employer. As such, an executive who obtains alternate employment within the reasonable notice period has mitigated or reduced the dam-

ages to which he or she is entitled by the amount of the executive's earnings.

With a Termination Clause

General

Increasingly, employers and executives are including termination provisions in employment agreements. Including termination provisions can clarify the obligations of the employer and the executive, provide certainty and, hopefully, reduce the risk of future litigation. The increased practice of negotiating and including termination provisions in employment agreements has reduced the concerns about the negative perceptions associated with negotiating termination provisions during the recruitment process. Also, an increased awareness of good compensation governance and the extensive wrongful dismissal case law have helped set parameters around termination provisions that are likely to be negotiated and acceptable to employers and executives, thereby facilitating the negotiation process. These parameters generally confine an employer's obligations and an ex-

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executive's entitlements on termination of employment to one to three years of compensation, the metrics of which are usually specified in the agreement.

Historical Implied Duty to Mitigate

The inclusion of express termination provisions in employment agreements impacts the obligations that courts would otherwise imply into the employment relationship. The impact of express termination provisions on an employer's implied obligation to provide reasonable notice of termination is, and always has been, clear in case law. Express termination provisions can displace the common law obligation to provide reasonable notice of termination, if properly implemented.

The impact of express termination provisions on an executive's implied obligation to mitigate his or her damages has been unclear to date. Until recently, Ontario courts often ruled that the executive's obligation to mitigate his or her damages continued, despite the express termination provisions, unless the termination provisions explicitly

or by implication relieved the executive of the duty to mitigate damages.

This interpretation often came as a surprise to executives and, sometimes even to employers, who were unaware that courts could imply a duty to mitigate damages despite the plain language in the agreement setting out the entitlements of executives on termination. As executives were unaware of the court's ability to imply a duty to mitigate on executives, they were often disadvantaged in the negotiation process because they did not know they needed to negotiate a waiver of this duty. As such, this interpretation ran contrary to the well-established view held by Canadian courts that employees are a vulnerable group in society deserving of protection who rarely have equal bargaining power with their employers.

This interpretation was also viewed as contrary to the goals of establishing certainty and finality in written agreements. By leaving open the issue of mitigation, there was a risk that litigation would ensue, particularly when the termination obligations were significant and the executive obtained alternate employment soon after the termination of his or her employment.

Further, the interpretation applied by the courts in Ontario was inconsistent with some decisions in other provinces. For example, the appeal courts in Alberta, British Columbia and Nova Scotia rejected the application of the implied duty to mitigate damages in the context of employment agreements with specified termination entitlements, unless the duty was expressly included in the agreement.

Express Duty to Mitigate

Recently, the Ontario Court of Appeal addressed the application of the implied duty to mitigate damages in the context of express termination provisions. The decision of the Ontario Court of Appeal in *Bowes v. Goss Power Products Ltd.* clarified the law and rejected the application of the implied duty to mitigate damages in the context of express termination provisions, unless the agreement explicitly provides otherwise.¹

In *Bowes*, Peter Bowes began working for Goss Power Products in October 2007 as its Vice-President, Sales and Marketing. Bowes had a written employment agreement setting out his entitlements on the



Ontario Court of Appeal — Osgoode Hall

Quebec Also Strikes out the Implied Duty to Mitigate

Recently, the Quebec Court of Appeal rejected the application of the implied duty to mitigate damages in the context of express termination provisions. In *Walker v. Norcan Aluminium Inc.*, Norcan Aluminium hired Jeff Walker as the head of the Ontario sales team.³ Walker signed a three-year employment contract in October 2007, which provided him an annual base salary of \$100,000, a bonus and a car allowance. The contract allowed Norcan Aluminium to terminate Walker's employment without cause before its expiry by providing Walker three months of notice of termination and payment of 50% of his base salary for the balance of the contract.

In February 2008, Norcan Aluminium terminated Walker's employment without cause. Norcan Aluminium claimed that Walker's contract was too costly considering the revenue generated in his territory. Norcan Aluminium offered Walker the opportunity to continue working as an independent representative, but Walker refused. Instead, Walker sued for the amount owing under the termination clause, which was approximately

\$155,000. From March 2008 to October 2010, Walker worked various jobs.

The trial court awarded Walker the amounts owed under the contract, but reduced the award by his mitigation earnings, for a net award of approximately \$4,500. The Quebec Court of Appeal overturned the trial court's ruling.

The Quebec Court of Appeal decided that the termination provision was a penal clause that fixed the anticipated damages in the event of a failure to perform a party's obligations under a contract. Under Article 1623 of the *Civil Code of Quebec*, a penal clause can be relied upon without having to prove damages. Consequently, the court held that this Article effectively removed the duty to mitigate damages under the employment contract. As a result, the Quebec Court of Appeal awarded Walker the nearly \$155,000 owed under the termination provision.

This decision brings Quebec in line with the interpretation by other provinces of the implied duty to mitigate damages in the context of express termination provisions.

termination of his employment without cause. Specifically, the employment agreement stipulated that Bowes' employment could be terminated without cause by providing Bowes:

"the following notice, or pay in lieu thereof: ... six (6) months if the Employee's employment is terminated prior to the completion of forty-eight (48) months of service."

The employment agreement was silent on whether Bowes had an obligation to mitigate his damages on the termination of his employment by seeking and accepting reasonable, alternate employment.

Bowes' employment was terminated without cause within four years, in April 2011. The termination letter provided that Bowes would be paid his salary and car allowance for six months, but during that period, Bowes had to seek alternate employment and inform Goss Power Products when he secured alternate employment.

Approximately two weeks after Bowes' employment with Goss Power Products

was terminated, Bowes obtained new employment at the same salary. Goss Power Products became aware of Bowes' re-employment and paid him only three weeks of pay in lieu of notice of termination, which was only the minimum statutory notice of termination required by the Ontario *Employment Standards Act, 2000*. Goss Power Products claimed that the termination amounts in excess of the three-week statutory amount were subject to Bowes' duty to mitigate his damages. Goss Power Products claimed that Bowes had fully mitigated his damages beyond the three-week statutory period of notice of termination so nothing more was owed to Bowes.

Goss Power Products relied on the then existing case law in support of its position. The then existing case law provided that, unless the employment agreement expressly or by implication relieved the employee of the duty to mitigate his or her damages on termination, the agreement was subject to the duty to mitigate.

The Ontario Court of Appeal rejected the position taken by Goss Power Products and held the company liable for the full ter-

mination pay stipulated in the employment agreement. The court rejected the application of the implied duty to mitigate damages in the context of an express termination provision, unless the termination provision explicitly required mitigation. The court noted that the fixed period of notice of termination or pay in lieu of notice in an employment agreement, in and of itself, displaced the implied obligation to mitigate damages, without further language to this effect.

This decision brings Ontario in line with the interpretation by other provinces of the implied duty to mitigate damages in the context of express termination provisions. This decision also aligns the law with how many, if not most, executives and employers understood their obligations in their employment agreements. It is fortunate that the Ontario Court of Appeal has taken this opportunity to correct and clarify the law in this area.

Recently, the Quebec Court of Appeal reached the same conclusion in *Walker v. Norcan Aluminium Inc.*, as described above.²

Endotes:

1 *Bowes v. Goss Power Products Ltd.*, 2012 ONCA 425 ("Bowes").

2 *Walker v. Norcan Aluminium Inc.*, 2012 QCCA 2042 ("Walker").

3 *Walker, ibid.*

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