



## Downsizing and Sale of a Business Unit

*by*

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### 1. **INTRODUCTION**

Adapting to a changing economy may lead an employer either to dismiss employees or to sell an entire business unit. Both events require careful planning.

Many employees, wrongly, view a potential severance package as an asset or an entitlement. Managing that expectation and knowing the extent of the employer's liability are important considerations in making the decision to downsize or sell.

This paper is intended to assist employers to know the extent of the potential liability, and plan a termination to reduce the potential for litigation.

### 2. **PLANNING FOR DISMISSALS**

#### I. **BRIEF REVIEW OF GOVERNING LAW**

In British Columbia, the following legal regimes govern the dismissal of non-union employees:

- The common law;
- The *Employment Standards Act*, R.S.B.C. 1996, c. 113; and
- The *Human Rights Code*, R.S.B.C. 1996, c. 210.

#### A. **The Common Law**

The common law imposes duties upon an employer: not to dismiss an employee without just cause or reasonable notice; not to act in bad faith in the dismissal process; and not to force an employee to take a demotion without reasonable notice or just cause.

**B. Employment Standards Act**

The purpose of the *Employment Standards Act* (the “*Act*”) is to provide employees in British Columbia with minimum working standards. Certain employees such as professionals are excluded from the operation of the *Act* as a whole. Other employees, such as managers and “high technology professionals” are excluded only from certain portions of the *Act*. If the *Act* applies, the parties cannot lawfully contract out of the provisions of the *Act*.

The *Act* sets out the minimum notice period obligations imposed on an employer when terminating an employee. The notice periods are as follows:

- Up to 3 months’ service – no notice
- 3 to 12 months’ service – 1 weeks’ notice
- 12 to 36 months’ service – 2 weeks’ notice
- 36 months’ service and more – 3 weeks’ notice, plus 1 week additional notice for each additional year of service up to a maximum of 8 weeks

It is important to note that the notice periods required by the *Act* are typically lower than the notice periods awarded by the court under the common law.

The *Act* also applies to the dismissal of pregnant or disabled employees.

Upon termination, the *Act* provides that, within forty-eight hours of the termination, the employer must pay to the employee all wages which are due to the date of the termination. “Wages” includes salary, commissions, unused vacation and banked overtime.

### C. *Human Rights Code*

The *Human Rights Code* (the “Code”) prohibits discrimination in employment, including dismissal, on the basis of the employee’s race, colour, ancestry, place of origin, political belief, religion, marital status, family status, physical or mental disability, sex, sexual orientation or age of that person or because of a criminal conviction or charge that is unrelated to the employment or the intended employment of that person. A decision to terminate an employee cannot be based on a prohibited ground. An employer who dismisses an employee based on one of the grounds is exposed to possible damages or even reinstatement of the dismissed employee.

If discrimination has been found, the following orders may be made:

- a cease and desist order for present practices, and the adoption of plans to prevent further occurrences;
- an order that the employer provide the opportunity denied to the employee;
- compensation for any lost wages or expenses incurred as a result of the discrimination, which would include the loss of income from employment;
- compensation for pain and suffering;
- costs against a party that in the opinion of the Tribunal has engaged in improper conduct during the course of the investigation or the hearing.

Unlike the common law, the Human Rights Tribunal is not bound to award compensation based upon the reasonable notice concept. The Tribunal has the authority, for instance, to award compensation for lost income for the entire period during which the employee was unemployed following the dismissal.

## **II. “WITHOUT CAUSE” TERMINATION**

### **A. The Meaning of “Reasonable Notice”**

Absent cause, an employer must provide an employee with “reasonable notice” of termination. Such notice, to be effective, must be clear and unequivocal: *Kalaman v. Singer Valve Co.* (1996), 19 C.C.E.L. (2d) 102 (S.C.), varied (1997), 31 C.C.E.L. (2d) 1 (B.C.C.A.).

The Court of Appeal has clarified in three decisions that the implied term of the employment contract is that the employer will give reasonable **working** notice; and it is not part of the implied term that the employer may give pay in lieu of notice (*Dunlop v. British Columbia Hydro & Power Authority* (1989), 32 B.C.L.R. (2d) 334 (C.A.), *Iacobucci v. WIC Radio Ltd.* (1999), 47 C.C.E.L. (2d) 163 (C.A.) and *Gillies v. Goldman Sachs Canada Inc.*, 2001 BCCA 683).

For the purposes of awarding damages, the employee is entitled to be treated as if she were an employee throughout the notice period with the corresponding duty on the employee to mitigate during that period. For, as the *Dunlop* decision notes, there would be no obligation on the employee to mitigate if the implied term were payment in lieu of notice.

If an employer makes a payment in lieu of notice it must be very careful to ensure that all contingent rights which may vest within the notice period are dealt with through payment and execution of a sufficiently particular release agreement, otherwise there is a significant risk that the employee will come back and ask for any outstanding rights.

### **B. What Constitutes “Reasonable Notice”?**

The purpose of providing “reasonable notice” is to provide the employee with a reasonable period of time to find alternative employment. What constitutes reasonable notice varies from case to case. There is no set formula under the common law upon which to determine reasonable notice.

The Court determines what notice period is “reasonable” on a case-by-case basis but considers the following factors, known as the “Bardal factors”:

- age of the employee;
- length of service;
- character of the employment; and
- availability of similar employment given the training and education of the employee.

Regarding the availability of similar employment factor, the Court has held that geographical location is a relevant consideration. For example, in *Olney v. Powell River Regional Hospital District* (1997), 31 C.C.E.L. (2d) 230 (S.C.), the Court awarded a longer notice period to a short-term employee due to the remoteness of the location (Powell River) and the unavailability of alternative equivalent employment in the area. It is also important to note that the employee had just recently relocated to Powell River from the Lower Mainland to accept the position.

Other factors may also affect the length of the notice period, such as whether the employee was induced to leave secure employment or given other inducements and was then terminated by the new employer: *Wallace v. United Grain Growers*, [1997] 3 S.C.R. 701.

### C. **Bad Faith**

An employer’s bad faith in terminating an employee can increase the notice period: *Wallace, supra*. The purpose of so doing is twofold:

- to compensate an employee for the negative impact such conduct may have on his or her ability to find alternative employment (thereby mitigating his or her damages); and,
- to punish employers for callous and insensitive treatment.

The obligation of good faith imposed on an employer is such that the employer is expected to be honest, forthright, and treat the employee fairly. The employer should not be unduly insensitive or mislead the employee in the termination process. The Court is careful not to define too rigidly the types of conduct which may constitute bad faith, nor does the Court merely look at the effect of the conduct on the employee's ability to find alternative employment. Conduct which does not affect the ability to find alternative employment may be compensated if it caused humiliation, embarrassment or damage to the employee's self-esteem.

Quantifying the bad faith element of the dismissal is not an easy task. Typically the more egregious the conduct, the higher the award will be, particularly where the conduct hinders the employee's ability to find alternate employment. The Court of Appeal in *Clendenning v. Lowndes Lambert (B.C.) Ltd.* (2000), 193 D.L.R. (4<sup>th</sup>) 610 (B.C.C.A.) has held that the bad faith element is simply one more of the factors to be considered and should not be considered separately. However, a few cases have indicated extensions of two to six months.

The bad faith element is not a consideration in determining what a reasonable notice period would be when planning dismissals but should serve as a guide to how employers behave when carrying out dismissals.

#### **D. Upper Limit of Reasonable Notice**

Notice periods vary widely but the Court has, generally, determined that the upper limit of the reasonable notice period is twenty-four months: *Kapelus v. University of British Columbia* (1998), 61 B.C.L.R. (3d) 308 (C.A.). Recent decisions, however, have demonstrated that special circumstances can push the upper limit beyond the twenty-four month mark, particularly with respect to long-service employees.

In *McKinley, supra.*, the Supreme Court of Canada upheld a jury's decision awarding twenty-six months notice to a wrongfully dismissed employee. In *McKinley*, the jury determined that the reasonable notice period was twenty-two months in the circumstances, given the long length of service and the senior position held by Mr. McKinley. However, the jury extended the notice

period by four months due to the “bad faith” of the employer in carrying out the dismissal. The “bad faith” arose from the following:

- The employer had dismissed Mr. McKinley while he was on short-term disability leave suffering from depression and hypertension.
- Mr. McKinley had difficulty obtaining a copy of his long-term disability plan from the employer.
- The employer had decreased its severance offer to Mr. McKinley during negotiations.

In the decision of the British Columbia Court of Appeal in *Singh v. B.C. Hydro and Power Authority*, 2001 BCCA 695, the Court awarded a twenty-seven month notice period to an employee. Mr. Singh had been employed for eighteen years and was, at the time of his termination, in the lower management position of mail-room supervisor. The Court increased the notice period because of the following factors:

- The employer had repeatedly assured Mr. Singh, through memoranda to all employees, that his employment was secure.
- Mr. Singh’s position was terminated abruptly after returning to work on a graduated basis following a difficult illness.

However, there have been no cases since then which have extended the notice period beyond twenty-four months. Thus, *Singh* and *McKinley* remain unusual cases.

### **III. PAYMENTS**

At common law, a wrongfully dismissed employee is entitled to the benefits during the notice period that he/she would have been entitled to had they been working in the usual course of

employment. Madam Justice Southin in *Nygard International Ltd. v. Robinson* (1990), 46 B.C.L.R. (2d) 103 (C.A.), enunciated this general principle at page 106-07 as follows:

When a contract is repudiated and the innocent party accepts the repudiation, which in my opinion is what happened here, the contract remains alive for the purpose of assessing the compensation to be paid. That compensation, that is to say, damages for the breach are what the innocent party would have received or earned depending on the nature of the contract had it been performed according to its terms. Here had it been performed according to its terms it would have been terminated within 30 days and thus, in my opinion, the defendant, the respondent in this Court, was entitled to whatever amount he would have earned in that 30 days according to the evidence. In this case that is approximately a month's salary and commission.

It is important to note that the Court is hesitant to award an amount for discretionary benefits. To recover such benefits, the employee must establish, on a balance of probabilities, that the benefit would have been received by the employee, if employed as usual during that period.

**A. Bonuses, Salary Increases, Commissions and Overtime**

If an employee can establish that he/she would have received, as an implied or express term of the employment contract, a salary increase or bonus during the notice period, then the employee will be awarded this amount. Bonuses that are awarded at the discretion of the employer are more difficult for employees to recover, since it can be argued that the employer would not have awarded the bonus during the period.

Furthermore, an employee is entitled to the commission income he/she would have earned had he/she worked during the notice period. It can often be difficult to quantify the commission income that an employee would have earned. In fact, the onus is on the employee to establish the commission losses claimed. In assessing the commission losses, the Court routinely examines factors which include the following:

- the employee's commission earnings during a comparable period in past years;
- the employee's more recent commission earnings; and,

- the health of the business – whether business is booming or declining and whether certain opportunities were arranged/planned.

The Court generally does not award overtime pay during the reasonable notice period. The assumption the Court makes is that the employer would not permit an outgoing employee to work overtime. However, that assumption may be overcome where an employee can show a longstanding track record of working overtime.

## **B. Vacation Pay**

The Court of Appeal has held in *Scott v. Lillooet School District No. 29* (1991), 60 B.C.L.R. (2d) 273 (C.A.) and in *Burry v. Unitel Communications Inc.* (1997), 46 B.C.L.R. (3d) 349 (C.A.) that a wrongfully terminated employee is not entitled to an award for damages equal to vacation pay for the notice period without evidence of loss or expense associated with the lost vacation benefits or a demonstration that the employee actually lost the opportunity to take vacation during that period.

The Court of Appeal has, however, made it easier for employees to claim lost vacation benefits. In *Bavaro v. North American Tea, Coffee & Herbs Trading Co.* (2001), 8 C.C.E.L. (3d) 24 (B.C.C.A.), the Court heard an appeal by the employer from a trial decision that awarded an amount for vacation pay. The employment contract had provided the employee with two weeks of vacation per year. The Court acknowledged the established and binding rule that no award for fringe benefits can be made unless the wrongly dismissed employee can establish that he or she actually incurred a loss as a result of losing the benefits. In that regard, the Court of Appeal held that the notice period is generally not a time of “worry-free leisure”. The dismissed employee has a duty to seek new employment and must report to work at the new job, if successful. Accordingly, the Court concluded that it is rarely an option for most dismissed employees to take a vacation. Although a dismissed employee claiming an award for lost vacation benefits must still show that a loss was suffered, the Court decided that the employee should not have to overcome a presumption that no loss was incurred because the employee was not obligated to report to work during the notice period. As the evidence in this case showed that the employee

did not enjoy any time off during the notice period such that it could be said he took a vacation, the award for lost vacation benefits was upheld.

**C. Medical, Dental and other Health or Life Insurance Benefits**

The Court has customarily held that an employee can recover actual costs that would have been covered by the employer's plan, incurred during the notice period, such as dental and medical costs. Thus, it is advisable that an employer maintain its coverage for all employees until the conclusion of the notice period.

However, the employee is under a corresponding duty to mitigate his losses by purchasing replacement benefits. If the employee does not do so, the employer may argue that the employee has failed to mitigate his losses. Where insurance plans are capable of being converted, the employee would be well-advised to do so and claim the premium costs.

**D. Disability Benefits**

An employee may be able to recover disability benefits during the reasonable notice period. In *Prince v. T. Eaton Co.* (1992), 91 D.L.R. (4<sup>th</sup>) 509 (B.C.C.A.), a wrongfully dismissed employee was totally disabled within the reasonable notice period. The employer disputed the employee's long-term disability claim arguing that the employee's disability arose after he ceased to be an employee. The Court concluded that the employee was entitled to disability benefits coverage until the conclusion of the reasonable notice period. The employer was required to make the disability benefits plan available to the employee during this notice period. As a result, the employer was liable for damages equivalent to the loss of the employee's long-term disability benefits under the employer's benefits plan.

Disability benefits, however, may represent a deduction from wrongful dismissal damages. The Supreme Court of Canada addressed this issue in *Sylvester v. British Columbia*, [1997] 2 S.C.R. 315. In *Sylvester*, the employee worked for the British Columbia government. The employer terminated the employee during a period when the employee was receiving disability benefits. The employee sought to recover damages for wrongful dismissal, in addition to the disability

benefits received during that period. The Supreme Court of Canada held that an employer may, in certain circumstances deduct disability benefits from a wrongful dismissal award. The Court indicated that disability benefits are intended to be paid when an employee cannot work whereas an award in lieu of reasonable notice assumes that the employee would have worked during the reasonable notice period.

However, it is important to note that the Court suggested that its decision may not extend to disability plans where the employee also makes contributions toward the premium cost of the plans, or where compensation is paid under a statutory scheme. Under such plans, the Court suggested that the employee may be providing additional consideration, and thus, it may not be appropriate to deduct the disability benefits from the damage award.

#### **E. Stock Options**

Losses from missed stock option opportunities may be recovered by a wrongfully dismissed employee. Employees are generally entitled to exercise the stock options that vest before the end of the notice period. For example, the Courts of Appeal in British Columbia and Ontario have confirmed in *Iacobucci, supra*, and *Veer v. Dover Corp. (Canada Ltd.)* (1999), 45 C.C.E.L. (2d) 183 (Ont. C.A.), that stock options continued to vest during the reasonable notice period, and terminated after the end of the reasonable notice period. The Court in *Veer* took the view that a stock option agreement that terminates options “on termination” of employment, is to be read as indicating termination at law – ie. at the end of the reasonable notice period. Thus, so long as the agreement does not specifically set out another date of termination of the options, the employee is entitled to exercise all options vesting before the end of the notice period.

In *Iacobucci, supra*, the British Columbia Court of Appeal dealt with a stock option plan whereby a person to whom an option has been granted ceases to be a full time employee of the Corporation as a result of his or her:

termination ... (regardless of whether the termination is voluntary or involuntary or with or without cause or adequate notice), unless otherwise determined by the

Committee, the options granted to that person may be exercised by that person only before the earlier of

- (A) the termination of the option, or
- (B) two (2) calendar months from the date of his or her termination

And only in respect of Class B non-voting shares which were available for purchase at the date of his or her termination. [Emphasis added.]

McEachern C.J.B.C. stated that the question which must be determined is whether the termination clause quoted above precludes the employee from exercising his future dated options and this depended on his status as a person who had been dismissed under salary continuance. Applying the decision in *Dunlop, supra*, the Court noted that the most important matters to consider were whether, at the time of the breach, there was payment in full of the salary likely to be earned during the period of reasonable notice (which did not occur) and the obligation to mitigate (imposed on the plaintiff). Presumably, the wording “voluntary or involuntary or with or without cause or adequate notice” were not sufficient to limit the employer’s exposure to the date of termination as opposed to the expiry of the notice period.

In *Gillies, supra*, the Court determined that an employee was entitled to participate in formula restricted stock units under the terms of an Initial Public Offering (“IPO”), like all other employees, given that the IPO was dated within his notice period. It is noteworthy that both in the *Iacobucci* and *Gillies* cases, the stock option agreement and stock IPO participation terms were characterized as discretionary. Yet, because, in effect, all employees were given the option to participate, the Court of Appeal confirmed that the unlawfully terminated employees had a right to participate which has been denied to them. Therefore, an employment agreement, term or plan which contains “discretionary” benefits and give the employer contractual discretion over who obtains those benefits will not necessarily be treated by the Courts as discretionary if, effectively, all employees were entitled to the benefits (and none were excluded).

However, where more detailed language is used, the Court has not awarded damages for lost stock options. For instance, in *Brock v. Matthews Group Ltd.* (1991), 34 C.C.E.L. 50 (O.C.A.),

the Ontario Court of Appeal considered entitlement to stock options vesting within the notice period pursuant to a clause worded as follows:

4. Upon the occurrence of any event specified in clause 10 hereof [which commenced 'In the event of the Employee ceasing to be an employee or servant of the Corporation'] (except the death of the Employee) prior to October 31, 1985, the option hereby granted shall forthwith cease and terminate and shall be of no further force or effect whatsoever as to such of the Optioned Shares in respect of which such option has not previously been exercised; 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 hereby granted in respect of the Optioned Shares available as of October 31 of the Year preceding such dismissal.

The Ontario Court of Appeal found in *Brock* that because the wording of the clause focussed on “notice of dismissal”, “dismissal” and “ceasing to be an employee”, the proper focus was on the date of termination when the notice of dismissal was given (not the end of the notice period).

In *Colby v. Electronic Arts (Canada) Inc.* (Unreported, November 20, 2002), Vancouver Registry No. S005858, the stock option plan provided the following language:

In no event shall vesting of the options extend beyond the date upon which the employee's employment with EA ceases, or if earlier, the date on which EA gives notice of such termination (the “Vesting End Date”). No potential value of the option shall be considered in determining any notice or compensation in lieu of notice that may be required or given upon termination of the optionee's employment by EA. This is a condition of the grant and the optionee waives any and all rights and claims the optionee may have to any option shares, or value attributable to option shares, which would have under any circumstances vested after the Vesting End Date (paragraph 11).

The Court found that the employee was not entitled to damages for lost stock options.

## **F. Car Allowance**

Whether an employee is entitled to compensation in lieu of a car allowance will depend upon how the parties treat the car allowance. Where the car allowance is treated as a reimbursement for an expense incurred by an employee in the course of carrying out business on behalf of the

employer, the Court will not make an award for car allowance: *Baumgart v. Convergent Technologies Canada Ltd.* (1989), 28 C.C.E.L. 250 (S.C.) and *MacGillivray v. TELUS Communications Inc.* 2004 BCSC 1394 (S.C.).

However, where the car allowance is treated as taxable compensation of the employee, and the employee treats the payment for tax purposes as a taxable benefit, the court will make an award for car allowance: *McDonald v. GBC Canada Inc.* 2004 BCSC 1029 (S.C.). In that situation, the Court will award an amount equal to the amount claimed by the employee as a taxable benefit.

#### **G. RRSP and Pension Contributions**

An employee is also entitled to recover the employer portion of contributions to RRSPs and pensions.

In addition, an employee may have an additional claim in respect of pension. The employee may claim the difference between the present value of the employee's pension plan on the date of termination and the present value of the employee's pension plan at the end of the reasonable notice period: *Sturrock v. Xerox of Canada Ltd.*, [1977] 1 A.C.W.S. 203 (B.C.S.C.)

#### **H. Maternity Leave**

Two British Columbia decisions have made it clear that a reasonable notice period cannot coincide with an employee's maternity leave. In *Elderfield v. Aetna Life Insurance Co.*, (1995) 11 C.C.E.L. (2d) 61 (S.C.), aff'd (1996), 27 B.C.L.R. (3d) 1 (C.A.), the employer notified the employee approximately two weeks before her leave commenced in December, 1993, that her employment would terminate when her maternity leave ended on August 15, 1994. The Court concluded that the employee was wrongfully dismissed on the last day of her maternity leave (August 15, 1994), without notice. The Court held that the period of reasonable notice could not run concurrently with the employee's maternity leave, and as a result, the employee was awarded damages in lieu of 14 months' reasonable notice.

In *Whelehan v. Laidlaw Environmental Services Ltd.* (1998), 55 B.C.L.R. (3d) 129 (S.C.), the employee's maternity leave began on July 18, 1997. The employer terminated the employee's employment by letter dated June 3, 1997. The termination was to be effective as of June 13, 1997. The Court determined that the employee was wrongfully dismissed and awarded her 8 months reasonable notice. In concluding that the reasonable notice period ran from June 3, 1997 until July 18, 1997, and then the balance ran after the end of the employee's maternity leave, the Court stated at page 133:

It is useful to compare the underlying purposes of reasonable notice and maternity leave. The law requires employers to provide dismissed employees with compensation for an adequate period of time to enable them to pursue suitable re-employment without unreasonable financial disadvantage. The philosophy behind maternity leave is that women who are pregnant are entitled to a leave of absence from their jobs in order to accommodate childbirth and they are entitled to the assurance that their job tenure is secure during the period of their absence. That philosophy is reflected in s.56 of the *Employment Standards Act*, R.S.B.C. 1996 c.113 ("the Act") which provides that the services of an employee on maternity leave are deemed to be continuous for the purposes of calculating vacation entitlement, pensions, medical benefits or other plans beneficial to the employee.

The policy basis underlying maternity leave – protecting pregnant women against penalties with respect to their job tenure and other terms of their employment by reason of pregnancy and childbirth – would be defeated if an employer could terminate a pregnant employee at the commencement of her maternity leave so that her period of notice was spent during that leave.

#### **IV. STRUCTURING SEVERANCE**

##### **A. Working Notice vs. Immediate Termination**

As noted above, the employer's obligation is to provide reasonable working notice. Under such notice, the employee continues to work while receiving his/her usual wage and benefits package until the end of the notice period. In this scenario, the question becomes whether the working notice period is reasonable in terms of length. A wrongful dismissal action may lie if the period of working notice is less than is required by the common law. If the period of working notice is too short, the employee may receive compensation in lieu of the extra month(s) of working notice that he/she should have received, subject to the employee's obligation to mitigate.

An employee has no right to demand a lump sum payment.

If the working notice period is not sufficient, the employee must wait until the end of the working notice period before commencing an action for the remainder. If an employee sues before the end of the working notice period, that act will amount to a repudiation of the employment contract: *Zaraweh v. Hernon, Bunbury & Oke* 2001 BCCA 524.

Many employers prefer, however, to terminate the employment immediately and pay an amount in lieu of giving reasonable notice. If the employer does so, it should determine what would have been the reasonable working notice period at common law.

#### **B. Lump Sum Payment vs. Salary Continuance**

If an employer opts to terminate an employee immediately rather than providing working notice, and just cause does not exist, the employer should decide how to structure the severance package. The employer may offer the employee a lump sum payment or it may wish to provide “salary continuance”, whereby the employer continues to provide the employee his/her salary and benefits, as usual, for the length of the notice period.

The primary advantage to the lump sum payment option is that the employer can sever ties to the employee with a single payment. Continued interaction between employer and employee ceases. An employee will generally prefer a lump sum payment because it permits the employee to structure the payment to minimise the immediate tax consequences of the payment. The downside to the lump sum payment option for the employer is that it does not allow for the possibility that the employee may mitigate his/her loss, either partially or entirely, by finding alternative employment shortly after termination. Thus, if an employee receives a lump sum payment and then finds alternative employment shortly thereafter, the employee may be receiving a windfall and the employer may be incurring an unnecessary expense.

The salary continuance option is advantageous from an employer’s perspective because it takes into account the possibility that the employee may mitigate his/her loss. In fact, salary

continuance can be designed to include a payout (frequently 50% of the remaining salary owed) where the employee obtains employment. This severance structure can effectively guard against a potential windfall to the employee. Furthermore, the salary continuance method enables the employer to make several, smaller, periodic payments for the duration of the notice period. In this respect, the employer is not forced to come up with one large lump sum payment at the time of dismissal.

Salary continuance may also benefit the employee, providing a regular source of income, while seeking alternative employment, especially if the employee does not expect to find alternate employment during the notice period.

However, an employer cannot impose salary continuance: *Tull v. Norsk Skog Canada Ltd.* 2004 BCSC 1098.

In addition, to obtain the full value of the benefit of mitigation, the salary continuance agreement must clearly set out the employee's obligations to look for work and the consequences of failing to look for work. In *Nelson v. Aker Kvaerner Canada Inc.* 2007 BCSC 535, the salary continuance agreement provided:

You agree to immediately notify the Company upon being employed or being engaged in other gainful employment, including self-employment, and will provide reasonable and regular reports of your job search and employment efforts.

The Court found that the clause required the employee to make reasonable efforts to find employment, but did not say what would happen in the event of a dispute between the parties regarding the amount of effort. In particular, the Court held that the employer was not entitled to cease making payments.

### **C. Taxation of Severance Payments**

An employer is required to deduct income tax from a payment to an employee in respect of loss of employment. Where an employer provides an employee with a lump sum severance payment,

the employer is not required to deduct C.P.P. or E.I. premiums, so long as the payment is classified properly as one in recognition of service or compensation for loss of employment.

Income tax should be deducted from the lump sum payment as follows:

- 10% if the payment is not more than \$5,000;
- 20% if the payment is more than \$5,000 but not more than \$15,000; and,
- 30% withholding if the payment is more than \$15,000.

Where the employer provides salary continuance to an employee during the notice period, the employer will be required to withhold taxes at the regular marginal rate.

#### **D. Other Withholding Obligations**

If an employee is only provided with the minimum severance payment under the *Act*, the employer is required to deduct and remit standard payroll deductions, such as E.I. and C.P.P. premiums.

Where an employee is awarded damages in lieu of notice or is paid an amount in respect of wrongful dismissal and has received E.I. benefits during the notice period, an employer is also obligated to withhold and remit the total amount of employment insurance benefits that the employee receives during the reasonable notice period.

#### **E. RRSP Contributions**

A portion of a severance payment may be transferred by the employer directly into an employee's RRSP account without deducting income tax depending on the employee's length of service. The eligible transfer amount is as follows:

- \$2,000 for each year or part of a year of service by the employee before 1996; and

- \$1,500 for each year or part of a year of service before 1989 provided that none of the employer's contributions to the employee's pension or Deferred Profit Sharing Plan have vested in the employee's name when the "retiring allowance" is paid.

In addition to the above, the employer may make RRSP contributions on behalf of the employee without deducting income tax. Regulation 100(3) to the *Income Tax Act* permits an employer not to withhold in respect of payments of premiums (i.e. contributions) under RRSPs to the extent that the employer believes on reasonable grounds that the premium is deductible in computing the employee's income for the taxation year in which the payment of remuneration is made.

#### **F. Releases**

It is imperative for an employer to obtain a full and comprehensive Release from the employee. The Release should bar long term disability claims, as well as other claims, such as claims under the *Act* and the *Code*. The employee need not execute the Release immediately and should be advised to take it away and seek independent legal advice.

The decision in *Hannan v. Methanex Corp.* (1998), 37 C.C.E.L. (2d) 228 (C.A.), serves as a cautionary tale when contemplating Releases. In *Hannan*, a former employee made claim for a performance bonus. Prior to making his claim, the parties had settled on an amount for a retirement allowance and the plaintiff had agreed to stay on in a different capacity. The Plaintiff signed a General Release and was paid the settlement amount. The Plaintiff decided that he did not want to continue with the employer in the new position and tendered his resignation, then claimed for the performance bonus.

The Court of Appeal agreed with the trial judge's view that the release in question did not contemplate the bonus in question, that the terms of employment were not limited to the employment agreement and that the entitlement claimed was not contingent upon the Plaintiff remaining an employee for the entire year.

## V. PREPARING FOR TERMINATION

The termination of an employee should be planned carefully. The communication of the decision to terminate the employee should be conducted in-person and employers must consider the impact of how they carry out the termination. Employers should be advised of the liabilities arising from the obligation to act in good faith. To the extent possible, the employer should have the letter, release (barring long-term disability claims, as well as all other claims, including claims under the *Act* and the *Code*) and paycheque for the employee up to the final day of employment ready for the employee. However, the employer should not pressure the employee to sign the release immediately (if the employee asks to sign the release immediately suggest that the employee take it away and think about it for a period of time) and should suggest independent legal advice if the employee has questions about the breadth of the release.

If the employee is a long-term employee, the employer may wish to consider providing career counselling. If the employer offers an Employee Assistance Program as part of the employee benefits, the employer should provide such information to the employee.

Set out below is a number of factors to consider.

1. Have the letter, release and final paycheque (including accrued vacation pay) for the employee up to the final day of employment ready to be presented to the employee. If the cheque is not available that day then it should be provided to the employee as soon as possible after the dismissal.
2. Make the payment of a severance offer conditional upon a release being executed.
3. If there is an EAP benefit, provide contact information as part of the package of documents, so that the employee may call a counsellor right away.
4. Conduct the dismissal in the employee's office or a neutral site.

5. Carry out the dismissal at the end of the day, preferably when other employees in the office have left, and near the beginning of the week.
6. Check to see whether the planned date of dismissal has any special significance for the employee (birthday, anniversary, etc.) and change the date accordingly.
7. Take steps to address security issues (e.g. keys, passwords, cards, tendency of the employee to become violent).
8. Consider an appropriate announcement to staff, customers, suppliers and others. Have that ready ahead of time.
9. Be careful about internal and external email communications concerning the employee and the dismissal, as these can be subject to disclosure in any subsequent litigation.
10. Refrain from engaging in any detailed discussion of the reasons for the dismissal with the employee. Employees have difficulty remembering the discussion accurately, and could become defensive and argumentative.
11. Keep the dismissal interview as short as possible (no longer than 15 minutes).
12. Have two senior persons present for the dismissal, one of whom will be the spokesperson.
13. Write out notes or a rough script in advance of the meeting.
14. Advise the employee that he/she can clean out the employee's office or desk immediately, or that you will arrange to do it at a later date.
15. Make sure that it is clear to the employee that the decision is firm and irrevocable.

16. Do not engage in a discussion regarding the reasons for the dismissal.
17. Ensure that the employee leaves the building without providing the appearance that the employee is being forcibly escorted out of the building.
18. Make arrangements for the employee to get home safely. Arrange for a cab if necessary.
19. Refrain from pressuring the employee to sign the release immediately. In fact, recommend to the employee to take the release away and seek independent legal advice prior to executing it.
20. Consider providing the employee with a list of lawyers to consult.
21. Shake the employee's hand at the end of the meeting and wish him or her good luck.
22. Make notes of the interview immediately thereafter in anticipation of possible litigation.

### **3. SALE OF A BUSINESS UNIT**

By virtue of section 97 of the Act, a purchaser of a business unit assumes all liabilities for the employees of that unit. The law deems the employment to be continuous. As a result, the severance liabilities for employees often become a significant business issue.

Set out below is a number of factors to be considered by both the vendor and the purchaser of a business unit.

#### **I. VENDOR'S OBLIGATIONS AND INTERESTS**

##### **A. Potential Obligations:**

The vendor may be required by the purchaser to dismiss employees before the closing date. Consequently, the vendor should review existing written employment contracts for potential severance liability; consider the reasonable notice periods for each and potential liabilities; and

consider the application of the Act and the Code. The vendor may also remain liable to the employees if the purchaser dismisses an employee after closing. Consequently, the vendor should obtain an appropriate indemnity.

**B. What the Vendor wants**

1. an offer of employment from the purchaser to all of the vendor's employees: same position and same compensation;
2. the purchaser to employ the vendor's employees for as long a period as possible, at least throughout the deemed "reasonable notice period";
3. to provide the employees with as much actual notice of termination (sale transaction) as possible; and
4. for any severance for employees who are not offered employment by the purchaser to be paid by the purchaser.

**II. PURCHASER'S OBLIGATIONS AND INTERESTS**

**A. Potential Obligations**

As noted above, the purchaser will inherit the service of any retained employees.

**B. What the Purchaser wants**

1. to employ those employees required to operate the business;
2. the vendor to terminate all employees' employment in writing before the closing;
3. to ensure that offers of employment be subject to probation and expressly provide that service with the vendor is not recognised.

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