

Structuring Severance Packages

EMPLOYEE DISCHARGE AND
DOCUMENTATION SEMINAR

by

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Structuring Severance Packages

1. Introduction

A costly mistake that employers frequently make, is failing to include a clear and enforceable termination provision in their employment contracts. This is due to a number of reasons. A key reason, is not wanting to consider details about how the relationship will end at a time when the relationship is just beginning. Another reason is thinking that the main terms of an employment agreement are limited to start date, position and duties and salary and benefits. Yet another reason is believing that the employment relationship is governed solely by employment standards legislation and that accordingly, the employer's obligation is limited to satisfying Section 63 of the BC *Employment Standards Act* (the "*ESA*").

The law however, is that an employer who dismisses an employee without cause, must provide the employee with reasonable notice or pay in lieu of such notice in accordance with the common law ("**Reasonable Notice**"). The presumption that an employer must give Reasonable Notice is rebutted if an employment contract contains a termination clause that clearly and unambiguously specifies the notice to be given in the event the employer wishes to terminate the relationship without cause.

2. Termination Provisions

(a) **Clear and unambiguous language**

As stated above, a termination provision must be clear and unambiguous if it is to be enforceable.

In *Boule v. Ericatel Ltd.*, 1998 CanLII 3881 (BCSC), the court found the following termination clause to be too vague and uncertain to enforce, mainly because the meaning of "provincial law" could not be easily ascertained:

If your employment is terminated for any reason other than "just cause" in law, then you will receive one week's notice of termination, or pay in lieu, for each year of employment in addition to whatever entitlement you have under the applicable provincial law.

In order to avoid the risk of uncertainty, an employer wishing to limit the amount of severance to *ESA* minimums, should mirror the length of service and termination pay amounts found in Section 63 of the *ESA* instead of paraphrasing it.

Section 63 of the *ESA*, requires an employer to provide the following minimum standards of notice of termination:

Period of Employment	Notice Required
More than 3 Consecutive Months	1 Week
More than 12 consecutive Months	2 Weeks
More than 3 Consecutive Years	3 Weeks notice plus one additional week for each additional year of employment up to a maximum of 8 weeks notice.

(b) The Ladner Downs rule

While employers generally provide the minimum amount of notice required by statute for regular employees, typically, managers and executives will be given more than the *ESA* minimums. In these kinds of situations, it is important to ensure that the severance being paid is always more than the maximum amount the employee would receive under the *ESA*; otherwise, the termination clause will be found to be unenforceable. Based on this requirement, commonly called the *Ladner Downs* rule after the case in which it was decided, the following clause would be unenforceable:

The Company may terminate your employment at any time without cause, by giving your one month's notice or pay in lieu of such notice or a combination of the two.

The clause is unenforceable in that even though the employee would receive more than the statutory minimum if he/she were terminated during the first few years of employment, if the employee is terminated after completing five years of service, he/she would get less than the statutory minimum.

(c) Comprehensive terms

A termination clause should be comprehensive and should be drafted in a way that permits the employer to give notice in the manner that works best for the employer. Thus, it is common to insert language that states the employer will give “notice or pay in lieu of notice or a combination of the two”. When it is time to end the relationship, this gives the employer flexibility to decide whether to give the employee working notice or to terminate the employment relationship immediately and pay the employee a lump sum or do a combination of the two.

3. Structuring Severance Packages

When an employer terminates an employment relationship other than for cause, it must give the employee notice. As discussed above, this would either be Reasonable Notice or contractual notice (in the event there is an enforceable termination clause). Because the latter situation is straightforward, the discussion that follows is in the context of providing Reasonable Notice.

(a) Reasonable Notice

In *Bardal v. The Globe & Mail Ltd.* (1960), 24 D.L.R. (2d) 140 (Ont. H.C.J.), the court stated the following about Reasonable Notice:

There can be no catalogue laid down as to what is reasonable notice in particular classes of cases. The reasonableness of the notice must be decided with reference to each particular case, having regard to the character of the employment, the length of service of the servant, the age of the servant and the availability of similar employment, having regard to the experience, training and qualifications of the servant.

Thus, reasonable notice is generally determined by the age of the employee, how long the employee has been with the employer, the employee's position (including salary) and the likelihood of the employee being able to obtain similar employment. The rough upper limit of reasonable notice awards is 24 months.

Once the amount of Reasonable Notice is determined, the next question is how the notice should be provided. Typically, Reasonable Notice can be provided as working notice, a lump sum payment in lieu of notice, salary continuance or some combination of the three.

Factors to consider in deciding how to structure the severance package would include:

- The reason for dismissal i.e., if the reason is poor performance, the employer may wish to give a lump sum payment rather than working notice. If, on the other hand, the employee is a productive employee and the reason that the employee is being let go is unrelated to performance, the employer may wish to give working notice.
- The employer's finances i.e., if the business is doing well and the employer can afford it, the employer may wish to give the employee a lump sum payment so that the employee can be got rid of quickly.
- The trustworthiness of the employee i.e., if the employee is untrustworthy or is a troublemaker, the employer may wish to get the employee out as quickly as possible to eliminate the possibility that he/she could destroy data, steal confidential information, create tension in the workplace, etc.

(b) Working Notice

Unless an employee is untrustworthy or there really is no work for the employee to do or the employee could negatively affect the morale of the workplace, it is preferable to give an employee working notice. That way, the employer gets value for the money that it pays the employee during the notice period. It also eliminates the hassle of trying to determine payments in lieu of benefits coverage and protects the employer from claims against loss of benefits.

If the employer gives insufficient working notice, this would amount to a breach of the employment contract and the employee is entitled to sue for wrongful dismissal. In this situation, damages will lie in an amount equivalent to the reasonable notice period minus the working notice given: *Giza v. Sechelt School Bus Services Ltd.*, 2012 BCCA 18 (“*Giza*”).

In *Giza*, the employer gave five weeks working notice to a bus driver, a 56 year old employee with 5 years service. The employer thought that the 5 weeks notice required by the *ESA* satisfied its obligation to provide reasonable notice. The employee refused to work out the notice period. The court held that the employee was entitled to an additional five months pay in lieu of notice. The court also held that the employee had repudiated the employment contract by failing to work during the notice period but that such repudiation did not deprive him of his right to damages for the employer’s breach of contract because that right had accrued when he was given inadequate notice. Accordingly, he was found entitled to the difference between reasonable notice and the actual notice given.

Important points:

- The employer should ensure that the working notice is clear and unequivocal and that the notice is in writing. If the notice is not in writing, it would violate Section 63 of the *ESA*.
- If an employer permits an employee to work beyond the notice period, the notice is ineffective under Section 67(1)(b) of the *ESA* and the employee would be entitled to a new statutory termination notice period or pay in lieu. For common law purposes, allowing an employee to work beyond the notice period could jeopardize the requirement that working notice must be clear and unequivocal.
- An employer must not alter the terms and conditions of the employee’s employment, during the working notice period as it would amount to a constructive dismissal.
- During the working notice period, an employee must continue to perform all of his/her duties as he/she normally would. However, it is customary for an employer to permit an employee to take a reasonable amount of time off for the purpose of attending job interviews, etc.
- If an employee brings an action for wrongful dismissal during the working notice period he/she will have repudiated the employment agreement.

- If an employee resigns during the working notice period, the employer does not have to pay the employee for the balance remaining period.
- If an employer terminates an employee for just cause during the working notice period, the employee will not be successful in claiming damages for wrongful dismissal.
- Once an employer gives working notice, it cannot unilaterally amend or retract the notice. In *Elderfield v. Aetna Life Insurance Co. of Canada* [1996] B.C.J. No. 1817, the employer gave the employee notice which suggested that the employer would provide a severance package or provide alternative work. As the notice was not specific and unequivocal, the employer subsequently tried to give proper working notice. The employee refused to accept the subsequent notice and brought an action. The court held that the employee was entitled to bring a claim for damages and that the employer could not unilaterally re-elect to provide additional working notice.
- An employer can offer a terminated employee another position as mitigation of his/her damages: In *Evans v. Teamster Local Union No. 31*, [2008] S.C.J. No. 20, a majority of the Canada Supreme Court held that the central question in these kinds of situations is whether, viewing the matter objectively, a reasonable person would have accepted the opportunity to mitigate his or her damages by returning to (or remaining at) work with the employer

(c) Lump sum payment

While this is a good way to get rid of a problem employee immediately, a lump-sum payment is costly to the employer because the employer has to make the payment up front. The other concern with lump sum payments is how you would calculate payment in lieu of benefits. While some employers add on a lump sum amount equivalent to the premiums that they would have paid for the benefits for the length of the Reasonable Notice period, this does not take into account the fact that replacement coverage will generally cost the employee much more.

Employees generally prefer lump sum payments because they get the money up front.

(d) Salary Continuance

In a salary continuance, the employer terminates the employment relationship, but continues to pay the employee's regular salary and benefits during the notice period. Typically, these are structured in such a way that the salary continuance ceases if the employee finds a comparable job with the employer agreeing to pay the employee a percentage of the balance left in the salary continuance period, as a lump sum. These so called "balloon clauses" are designed to encourage the employee to find alternative employment.

The advantage of salary continuance is that an employer can terminate an employee's services immediately without having to come up with a lump sum. Another advantage is that the employer may be able to continue the employee's benefits for all or some of the salary

continuance period (this would however, depend on the terms of the benefit plans and employers should check with the benefits carrier before committing to continue any benefits). Finally, another advantage to salary continuance is that some employees would find it attractive to have a guaranteed income for a certain period of time and may therefore be less inclined to file a wrongful dismissal claim.

Important points:

- While courts do not encourage salary continuance, they have the discretion to permit salary continuance arrangements if the notice period is reasonable.
- In *Tull v. Norske Skog Canada Limited*, 2004 BCSC 1098, the court stated that “discretion should only be exercised in favour of a salary continuance arrangement if the amount to be paid to the employee in accordance with its terms is equivalent to that which the employee would have received had he or she been dismissed with working notice.”
- In order for the salary continuance to be reasonable, it must be at the higher end of the appropriate range i.e., for example, if the reasonable notice period is 9 – 12 months, a salary continuance should reflect a notice period of 11-12 months, not 9 months.
- The courts will carefully scrutinize any conditions that are attached to the salary continuance: *Albach v. Vortek Industries Ltd.*, 2000 BCSC 1228. This means that employers must be careful about imposing conditions such as requiring the employee to keep the employer apprised of his/her efforts to find alternative employment, asking the employee to sign a non-competition clause and/or non-solicitation clause, etc.
- Based on *Light v. City of Richmond*, [1998] B.C.J. No. 102 (S.C.), salary continuance is allowed only where the employer offers it in the original termination letter sent to the employee.

(e) Releases

Employers should always get a release of all claims from the employee in exchange for the payment of severance. Two important things to remember with respect to obtaining a release are: (a) to give the employee sufficient time to consider the severance package and the release before signing off on the release; and (b) a release is not enforceable if the employer is only giving the employee what he/she is entitled to anyway either under the *ESA* or contractually.

4. Garden Leave

Giving an employee “garden leave”, is not a common method of structuring severance payments in Canada although it is common in England. In a garden leave situation, the employee is provided with notice that his/her employment will be terminated at a future date and paid his/her salary up to that date but is required to cease work immediately.

Garden leave allows an employer to spread the payments over a period of time, much the same as a salary continuance and allows the employer to remove the employee from the workplace, thereby eliminating the risk of theft of confidential information; destruction of property, etc. Another advantage of garden leave is that it discourages an employee from bringing an action during the notice period because the employee runs the risk of repudiating the employment agreement if he/she brings such an action. Additionally, because the employee gets paid for doing nothing, an employee is less likely to bring such an action. This is also an ideal way to prevent an employee from competing with the employer for a given period of time without the hassle of restrictive covenants which may or may not be enforceable.

One risk with garden leave is that an employer may not be able to continue benefits during the garden leave period. If the benefits plans do not permit the continuation of benefits and the employer is forced to discontinue some or all of the benefits, this could amount to a constructive dismissal.

5. Conclusion

This paper is intended to provide you with a brief overview of termination provisions and the different methods of structuring severance packages and is not intended as legal advice. This is a complex area and one that frequently involves litigation or threat of litigation with employers having to spend a significant amount of time and money to either defend or settle. Severance packages for senior executives in particular, are extremely complex and fraught with significant tax considerations and other pitfalls that could end up costing an employer a considerable amount of money. On a practical note, therefore, it is advisable to seek legal counsel before structuring a severance package, especially for more senior employees.

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