

HR Insider
Webinar

STRUCTURING SEVERANCE PACKAGES

MAY 7, 2014

Presented by Heather Hettiarachchi



These materials are not to be reproduced without the permission of the author.

Introduction

- The starting point for any discussion on severance, is the employment contract.
- Unfortunately, some employers do not have written employment agreements.
- Some employers have written agreements but fail to include a termination clause in the agreement.



Introduction

- Reasons for failing to include a termination provision, include:
 - Not wanting to consider details about how the relationship will end when it is just beginning;
 - Thinking that the main terms are limited to start date, position and duties, salary and benefits; and
 - Believing that the employment relationship is only governed by employment standards legislation.

Introduction (cont'd)

- The Law
 - an employer who dismisses an employee without cause **must** give the employee 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 of a termination without cause.

Termination Provisions

a. Clear and unambiguous language

- A termination provision must be clear and unambiguous if it is to be enforceable.



Termination Provisions (cont'd)

a. Clear and unambiguous language

In *Boule v. Ericatel Ltd.*, 1998 CanLII 3881 (BCSC), the court held that the following termination clause was too vague and uncertain to enforce.

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.

Main reason for holding that the clause was unenforceable, was that the meaning of “provincial law” could not be easily ascertained.

Termination Provisions (cont'd)

b. The Ladner Downs Rule

- If the severance in the employment agreement is not limited to the employment standards minimums, it **must** always exceed the maximum amount the employee would receive under applicable employment standards legislation; otherwise, the termination clause will be unenforceable.
- This is commonly called the *Ladner Downs Rule* after the case in which it was decided.

Termination Provisions (cont'd)

b. The Ladner Downs Rule

- The following termination clause is commonly found in employment agreements.

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

Termination Provisions (cont'd)

- The clause is unenforceable under the *Ladner Downs Rule*.
- It is unenforceable because the employee would receive less than the statutory minimum (under BC employment standards legislation) if the employee is terminated after completing five years of service.



Termination Provisions (cont'd)

- Under the BC *Employment Standards Act (ESA)*, the minimum termination pay, or severance, is as follows:

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.

Termination Provisions (cont'd)

- An employer wishing to limit the amount of severance to employment standards minimums should mirror the length of service and termination pay amounts found in applicable employment legislation, instead of paraphrasing it.

Termination Provisions (cont'd)

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.
- 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”.

Structuring Severance Packages

SUMMARY

- If an employer terminates an employment relationship without cause, it **must** give the employee notice.
- This would either be Reasonable Notice or contractual notice (in the event there is an enforceable termination clause)
- To be enforceable, the contractual notice must meet or exceed the employment standards minimums.

Structuring Severance Packages (cont'd)

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.

Structuring Severance Packages (cont'd)

a. Reasonable Notice

- 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.

Structuring Severance Packages (cont'd)

a. Reasonable Notice

- A common misconception is to calculate severance on the basis of one month for each year of service.



- This is NOT the law and this principle should not be followed.

Structuring Severance Packages (cont'd)

a. Reasonable Notice

- 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.

Structuring Severance Packages (cont'd)

- Factors to consider in deciding how to structure the severance package would include:
 - The reason for dismissal - if the reason is poor performance, the employer may wish to give a lump sum payment rather than working notice.
 - The employer's finances - 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.

Structuring Severance Packages (cont'd)

- The trustworthiness of the employee. 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.



Structuring Severance Packages (cont'd)

b. Working Notice

- Unless an employee is:
 - untrustworthy;
 - 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.

Structuring Severance Packages (cont'd)

b. Working Notice

- The advantages of working notice include:
 - The employer gets value for the money that it pays the employee during the notice period;
 - It eliminates the hassle of trying to determine payments in lieu of benefits coverage; and
 - It protects the employer from claims against loss of benefits.

Structuring Severance Packages (cont'd)

b. Working Notice

- If an 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***”).

Structuring Severance Packages (cont'd)

b. Working Notice

- 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 BC *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.

Structuring Severance Packages (cont'd)

b. Working Notice

- In *Giza*, the court also held:
 1. The employee had repudiated the employment contract by failing to work during the notice period; and
 2. this repudiation did not deprive him of his right to damages because the right had accrued when he was given inadequate notice.

Structuring Severance Packages (cont'd)

b. Working Notice

Important points:

- The employer should ensure that:
 1. the working notice is clear and unequivocal; and
 2. the notice is in writing.

If the notice is not in writing, it would violate Section 63 of the BC ESA.

Structuring Severance Packages (cont'd)

b. Working Notice

- If an employer permits an employee to work beyond the notice period, the notice is ineffective under section 67(1)(b) of the BC *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.

Structuring Severance Packages (cont'd)

b. Working Notice

- An employer must not alter the terms and conditions of the employee's employment during the working notice period – doing so would amount to a constructive dismissal.
- During the working notice period, an employee must continue to perform all of his/her duties as the employee normally would.
- 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.

Structuring Severance Packages (cont'd)

b. Working Notice

- If an employee brings an action for wrongful dismissal during the working notice period this is a repudiation of 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.

Structuring Severance Packages (cont'd)

b. Working Notice

- 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.



Structuring Severance Packages (cont'd)

b. Working Notice

- The employer realized that the notice was not specific and unequivocal, and tried to subsequently give proper working notice.
- The employee refused to accept the subsequent notice and brought an action for wrongful dismissal.
- 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.

Structuring Severance Packages (cont'd)

c. Lump Sum Payment

- There are two concerns with respect to lump sum payments from the employer's perspective:
 - A lump sum payment is costly to the employer because the employer has to make the payment up front; and
 - It is difficult to calculate payment in lieu of benefits.
- 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. However, this does not take into account the fact that replacement coverage will generally cost the employee much more.

Structuring Severance Packages (cont'd)

c. Lump Sum Payment

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



Structuring Severance Packages (cont'd)

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, the salary continuance stops if the employee finds a comparable job and the employer will agree to pay the employee a percentage of the balance as a lump sum.
- These so called “balloon clauses” are designed to encourage the employee to find alternative employment.

Structuring Severance Packages (cont'd)

d. Salary Continuance

- The advantages of salary continuance include:
 - An employer can terminate an employee's services immediately without having to come up with a lump sum;
 - The employer may be able to continue the employee's benefits for all or some of the salary continuance period (this depends on the terms of the benefit plans and employers should check with the benefits carrier before committing to continue any benefits); and
 - 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.

Structuring Severance Packages (cont'd)

d. Salary Continuance

- 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.”

Structuring Severance Packages (cont'd)

d. Salary Continuance

- In order for the salary continuance to be reasonable, it must be at the higher end of the appropriate range. 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.

Structuring Severance Packages (cont'd)

d. Salary Continuance

- Employers must be careful about imposing conditions such as requiring the employee to keep the employer informed of his/her efforts to find alternative employment and asking the employee to sign restrictive covenants such as a non-competition clause and/or a non-solicitation clause.
- In *Light v. City of Richmond*, [1998] B.C.J. No. 102 (S.C.), the court held that salary continuance is allowed only where the employer offers it in the original termination letter sent to the employee.

Structuring Severance Packages (cont'd)

e. Mitigation

- An employer can offer a terminated employee another position in 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.

Structuring Severance Packages (cont'd)

f. Tax Issues

- Wages in lieu of termination notice under the terms of an employment contract or employment standards legislation, is employment income.
- You must deduct CPP contributions, EI premiums and income tax from wages in lieu of termination.

Structuring Severance Packages (cont'd)

f. Tax Issues

- Payments further to common law reasonable notice are considered a retiring allowance.
- A retiring allowance includes payments for unused sick leave credits.
- **It does not include:**
 - Superannuation or pension benefits

Structuring Severance Packages (cont'd)

f. Tax Issues

- When you pay a retiring allowance to a resident of Canada, you must deduct income tax from the monies that you pay directly to the employee. The deduction is as follows:
 - 10% (5% for Quebec) on amounts up to and including \$5,000;
 - 20% (10% for Quebec) on amounts over \$5,000 up to and including \$15,000; and
 - 30% (15% for Quebec) on amounts over \$15,000.

Structuring Severance Packages (cont'd)

f. Tax Issues

- Amounts that are not paid directly to the employee are not subject to withholding taxes.
- Examples:
 - Amounts paid to a RRSP
 - Legal fees

Structuring Severance Packages (cont'd)

g. Releases

- Employers should always get a release of all claims from the employee in exchange for the severance payments.



Structuring Severance Packages (cont'd)

g. Releases

- Two important things to remember with respect to obtaining a release are:
 - to give the employee sufficient time to consider the severance package and the release before signing off on the release; and
 - it is not enforceable if the employer is only giving the employee what he/she is entitled to anyway either under employment standards legislation or under their contract.

Structuring Severance Packages (cont'd)

h. Garden Leave

- In a garden leave situation, the employee is provided with notice that the employee's employment will be terminated at a future date and salary paid up to that date.
- However, the employee is required to cease work immediately.
- This is not a common method of structuring severance payments in Canada.

Structuring Severance Packages (cont'd)

h. Garden Leave

- The advantages of garden leave include:
 - It allows an employer to spread the payments over a period of time, much the same as a salary continuance.
 - It allows the employer to remove the employee from the workplace, thereby eliminating the risk of theft of confidential information, destruction of property, etc.

Structuring Severance Packages (cont'd)

h. Garden Leave

- 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
- Because the employee gets paid for doing nothing, an employee is less likely to bring such an action; and
- It 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.

Structuring Severance Packages (cont'd)

h. Garden Leave

- 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.



Structuring Severance Packages (cont'd)

Conclusion

- Structuring severance packages is very complex and one that frequently involves litigation or threat of litigation.
- 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, it is always advisable to seek legal counsel before structuring a severance package.

THANK YOU

These materials are necessarily of a general nature and do not take into consideration any specific matter, client or fact pattern and should not be relied on as legal advice.

Please direct inquiries or comments to:

Heather Hettiarachchi, Clark Wilson LLP
hmh@cwilson.com | 604.891.7791
www.cwilson.com