

WE DO NOT THINK IT MEANS WHAT YOU THINK IT MEANS: THE ONTARIO COURT OF APPEAL ADDRESSES INCENTIVE COMPENSATION PLANS IN *O'REILLY V. IMAX CORPORATION*

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For the past half-decade, the interpretation of termination clauses have been front and centre in employment litigation in Ontario. However, the interpretation of incentive pay and bonus clauses is closing in on the lead.

In *Reilly v. IMAX Corporation* (2019 ONCA 991) (“*IMAX*”), the Court of Appeal recently confirmed the appropriate framework for interpreting an incentive pay provision in a compensation policy and determining whether or not an employee is entitled to incentive pay as part of his or her damages over the common law notice period.

In *IMAX*, the Court of Appeal examined a long-term incentive plan (“LTIP”) that formed a fundamental part of the plaintiff’s compensation. The LTIP provided that restricted stock units that had been granted to an employee but had not yet vested to the employee would be cancelled upon termination, no matter the reason for termination, as follows:

“In the event that the Participant’s employment with the Company terminates for any reason other than death, Disability or for Cause, the RSUs shall cease to vest and any unvested RSUs shall be cancelled immediately without consideration as of the date of such termination. Any vested RSUs shall continue to be settled on the applicable Settlement Date.”

When Mr. O’Reilly’s employment was terminated, IMAX immediately cancelled several unvested RSUs that would otherwise have vested during the applicable notice period. Mr. O’Reilly sued for wrongful dismissal and sought, among other things, compensation for the cancelled RSUs. After a motion judge found in Mr. O’Reilly’s favour on summary judgment, IMAX appealed.

Framework for analysis

The Court of Appeal closely examined a handful of past decisions in which the Court has addressed the interpretation of an incentive plan and set out the following steps and principles to apply in cases in which an employee’s alleged common law entitlement to incentive pay was at issue:

- A. A wrongfully dismissed employee is entitled to damages for the loss of wages and other benefits that would have been earned during the reasonable notice period;
- B. This principle applies to bonuses, stock options, or incentives that are an integral part of the employee's compensation, as well as pension benefits that would have accrued or been earned during the reasonable notice period;
- C. In considering whether the loss of such benefits is recoverable, the Court undertakes a two step analysis:
 - i. The first step requires a determination of the employee's common law right to damages for breach of contract, bearing in mind that the measure of damages is the amount to which the employee would have been entitled had the employer properly provided working notice of termination; and
 - ii. The second step requires the Court to determine whether the terms of the relevant contract or plan unambiguously alter or remove the employee's common law rights, having regard to the presumption that the parties intended to apply the law, in the absence of clear language to the contrary.

Application of two-part test in *IMAX*

In *IMAX*, the Court of Appeal focused largely on the final step of the above test. The Court held that the phrase "terminates for any reason" could not be presumed to refer to termination without cause and that the phrase "cancelled immediately without consideration" did not clearly remove the employee's right to damages on account of the LTIP over the common law notice period. Unlike plans in other cases, the Court found the plan did not unambiguously establish when the date of termination of employment was effective and left open the argument that the date of termination is at the end of the reasonable notice period.

Because the plan language did not expressly state that the employee had no entitlement to compensation under the LTIP during the applicable common law notice period, the employee could not be presumed to have contracted out of his entitlement to an integral part of his compensation over the reasonable notice period.

The Court of Appeal awarded Mr. O'Reilly damages equivalent to the RSUs that would have vested and that he would have purchased during the applicable notice period.

Lessons for Employers

The Court of Appeal's decision in *IMAX* once again reminds us that Ontario courts are unlikely to deny an employee incentive compensation over the reasonable notice period unless the employment contract or incentive plan expressly and unequivocally contracts out of that entitlement.

The good news for employers is that it is possible to draft plan language and employment agreements that ensure that the incentive compensation is excluded from any damages awarded for reasonable notice period,

either through terms addressing the benefit itself, or through carefully drafted termination language (or ideally, in both). However, it does require employers to consider the language carefully, particularly where incentive compensation is involved, as the consequences of not including express language can be expensive.

by Dave McKechnie and Kyle Lambert

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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