HUNTER-LIBERATORE-LAW

How to Calculate Wrongful Dismissal Damages for Variable Compensation

• Introduction

Where an incentive plan pays out annually, is a terminated employee entitled to a pro-rated bonus calculated based on an average of their historical payouts? Alternatively, is a terminated employee only entitled to the bonus that would have been paid during the reasonable notice period? In this article, we explore these questions considering the recent Ontario Court of Appeal decision in *Manastersky v. Royal Bank of Canada*, 2021 ONCA 458 (CanLII).

• General Principles Regarding Damages for Wrongful Dismissal and Variable Compensation

In the recent *Matthews v. Ocean Nutrition* Supreme Court of Canada decision, the Court considered whether Mr. Matthews was entitled to a Long Term Incentive Plan (LTIP) payment. In considering that question, the Court noted:

> … the remedy for a breach of the implied term to provide reasonable notice is an award of damages based on the period of notice which should have been given, with the damages representing "what the employee would have earned in this period" (para. 115) [referencing *Wallace v. United Grain Growers*].

On its face, this seems like a straightforward concept:

- Imagine the employee worked during the notice period.
- Calculate the value of what they would have received in compensation during this time: salary, bonuses, use of a vehicle, other prerequisites, benefits, etc.

However, when it comes to variable compensation, there is often significant disagreement on how to calculate what the employee would have received. Consider for a moment the following scenarios:

- The employee's variable compensation is determined by company performance and the company experiences a severe downturn during the notice period.

- The employee's variable compensation is determined by employee performance and the employee's performance was on a downslide leading up to the decision to terminate their employment.

Both the downturn in the company performance and the employee's individual performance would have reduced or eliminated the entitlement to a bonus if the employee continued to work. However, plaintiff counsel often argue that damages for the bonus should be calculated based on historical averages, not the actual data.

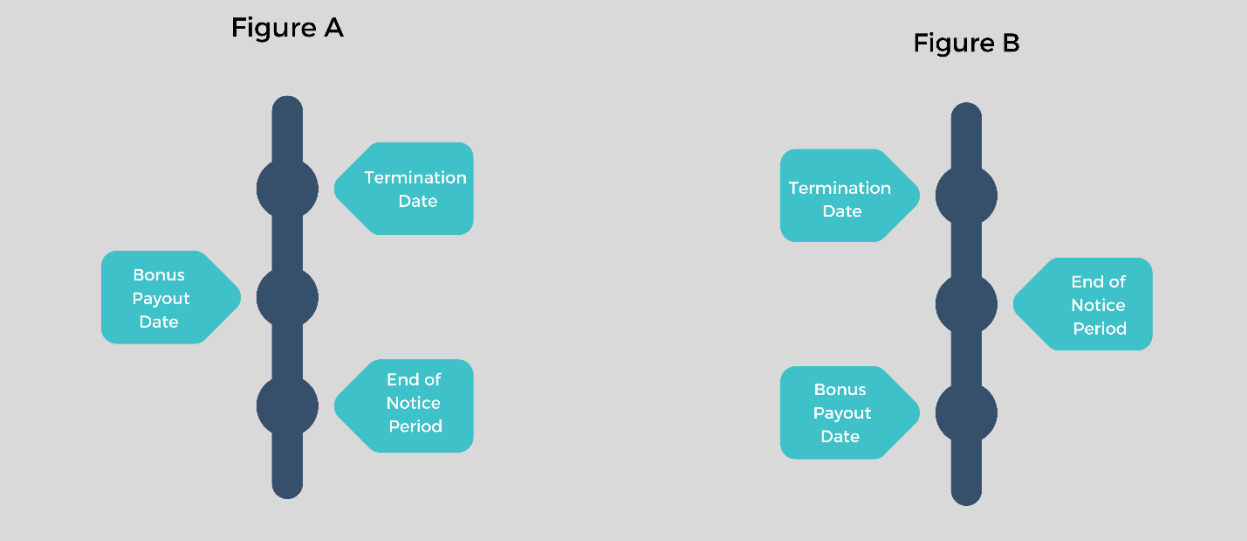
Another complication to determining an employee's entitlement is the terms of the variable compensation plan. That issue was also considered in the *Matthews* case where there was an LTIP plan that generated a large payment if a "Realization Event" occurred. The Realization Event did occur during the notice period, but the employer argued that Mr. Matthews was not entitled because he did not meet the requirement under the LTIP plan that he be actively employed on the date of the Realization Event.

The Supreme Court adopted the following method of analysis to determine whether compensation related to variable compensation is owed to a wrongfully dismissed employee:

> Courts should accordingly ask two questions when determining whether the appropriate quantum of damages for breach of the implied term to provide reasonable notice includes bonus payments and certain other benefits. Would the employee have been entitled to the bonus or benefit as part of their compensation during the reasonable notice period? If so, do the terms of the employment contract or bonus plan unambiguously take away or limit that common law right?

In the *Matthews* case, the Court found that the LTIP plan did not take away Mr. Matthews' common law entitlement and he was awarded the payment that arose from the "Realization Event" because the event occurred during the notice period.

A simple graphic representation of the *Matthews* case is Figure A below.



Inferred from the *Matthews* analysis is that if the bonus payout date occurs after the expiry of the notice period (Figure B), there should be no entitlement to a bonus. This would be the case, even if the employee has worked during the qualification period and arguably partially "earned" the bonus. It is perhaps understandable that the courts have commented on the perceived unfairness of an "all or nothing" approach to annual bonuses where the effort is expended, but the reward disallowed because of the timing of the payout date. The *Manastersky* case discussed in the next section of this article explores this issue and identifies two competing approaches to the damages calculation which we will refer to as the "Purist" approach and the "Pro rata" approach.

- ***Manastersky v. Royal Bank of Canada***

Under the Purist approach, the courts have determined that the strict language of an incentive plan determines whether a wrongfully terminated employee is entitled to damages for incentive compensation during the reasonable notice period. On the other hand, some jurists have opined that an employee must be compensated on a Pro rata basis for the lost opportunity to earn incentive compensation, even if the terms of the incentive plan itself disentitle the employee from receiving this compensation during or after the reasonable notice period. Both these lines of reasoning are present in *Manastersky v. Royal Bank of Canada et. al*, 2019 ONCA 609 (CanLII).

A. Facts

James Manastersky was employed by RBC Capital Partners for 13 years. He was hired as the Director of the company's Mezzanine Fund, with a base salary of $200,000 a year, a bonus, and participation in the company's Carried Interest Plan (the "CIP").

The CIP was a complex incentive compensation plan. A simplified explanation of the terms of the plan are as follows:

- Participants were awarded points at the discretion of management.
- Each point allocation expressly stated that there was no agreement or commitment that future points would be awarded.
- The CIP contemplated "Investment Periods", the temporal length of which was determined by the cumulative dollar amount of investments made in the given investment period.
- Terminated employees with vested points in an Investment Period continued to participate retaining "in all Portfolios with respect to which he or she has Points, all rights represented by his or her Vested Points".
- Two Investment Periods were established and Mr. Manastersky's entitlements under those funds vested.
- A third Investment Period was contemplated but the plan included a term that the CIP's Management Committee was entitled to terminate the CIP effective "as of the end of any Investment Period with respect to future Investment Periods".
- The timing of payments under the CIP was tied to the end of Investment Periods.
- The Bank decided not to commence a third Investment Period and to transfer the management of the fund to a different business line within the bank.

Mr. Manastersky was offered a new position as the transfer of the management of the fund eliminated his position. He chose not to accept a new position and was offered 13 months notice.

Mr. Manastersky did not receive any Mezzanine CIP payments from 2008 to 2014 as the Investment Periods continued to run and payment was not owed until they ended. His interests in Investment Periods 1 and 2 were paid to him as the funds were transferred within the bank, triggering the end of the

Investment Periods. In 2015 and 2016 he received payments in excess of $5,000,000.00.

B. The Trial Decision

Mr. Manastersky sued for wrongful dismissal. As part of his claim, he sought compensation for the lost opportunity to earn additional amounts from the Fund during that notice period. RBC argued that the terms of the CIP allowed termination of the plan at the end of any investment period. Since RBC did in fact discontinue the Fund and the CIP during Manastersky's reasonable notice period, the plaintiff was not entitled to any further compensation.

The trial judge held that the CIP represented an integral part of Manastersky's compensation and there were no provisions in the CIP eliminating or limiting his entitlements upon termination. If he had remained employed until June 2014 when the CIP was terminated, the Court reasoned that this unilateral significant reduction in his compensation would have amounted to constructive dismissal triggering an entitlement to damages at common law. In calculating the damages owed, the Court averaged his CIP entitlements over his 13-year employment period and applied that to the 18-month notice period resulting in a total damage award of $953,392.50 with respect to the CIP (the Pro rata approach).

C. The Court of Appeal Majority

Justice Brown (B.W. Miller J.A. concurring) of the Court of Appeal subsequently overturned this portion of the Superior Court's judgment. The Court found that the trial judge had erred in determining that Manastersky was entitled to common law damages merely because the payments under the Plan were a significant form of compensation. Instead, the trial judge should have determined what the plaintiff would have earned in respect to the CIP had RBC not breached the contract of employment (the Purist approach).

Under the specific terms of the Plan, which were fully disclosed to Manastersky, no participant had the express or implied right to any payments for future investment periods. RBC could terminate the Plan at the end of any investment period – and it did so in June 2014. The termination of the Plan in accordance with its terms did not breach Manastersky's employment contract and would not have amounted to constructive dismissal as RBC was exercising a right it had under the contract.

In other words, the majority of the Court of Appeal adopted the Purist approach.

D. The Dissent

In his dissent, Justice Feldman determined that Manastersky was entitled to the Pro rata CIP damage award. Like the trial judge, Justice Feldman found that RBC could not unilaterally terminate an integral component of Manastersky's compensation without replacing it with a comparable form of compensation. Justice Feldman believed it was unlikely that Manastersky would have knowingly agreed that RBC could unilaterally remove over 50% of his compensation. Clearer language was therefore required to remove his common law entitlements to receive compensation in an amount equivalent to what would have been earned from the CIP during the reasonable notice period.

E. Leave to Appeal to the Supreme Court of Canada

Mr. Manastersky appealed to the Supreme Court. The Court remanded the case back to the Court of Appeal to be decided in accordance with its decision in *Matthews* which was released after the Court of Appeal's decision.

F. The Second Court of Appeal Decision.

The Court of Appeal reviewed its first decision considering *Matthews* and the majority affirmed its original ruling (see *Manastersky v. Royal Bank of Canada*, 2021 ONCA 458 (CanLII).) The Court held that the clear terms of Mr. Manastersky's employment contract did not entitle him to receive an annual incentive payment. The terms entitled him to receive a fund-specific incentive payment upon the end of a fund's investment period. He was paid those incentive amounts upon the conclusion of the investment period and was not entitled to further damages once the Fund was wound up.

Once again, Justice Feldman dissented finding that the CIP was an integral part of Manastersky's compensation package. RBC's right to discontinue the plan was not an unambiguous right to also reduce Manastersky's compensation, while he remained employed or in the reasonable notice period following the termination of his employment.

- **Conclusion Regarding the Purist v. Pro rata Approach**

The most recent decision of the majority of the Court of Appeal in Ontario endorses the Purist approach to damages where the terms of an incentive plan

determine what, if anything, an employee is entitled to under that plan during the notice period. In the interest of brevity, we have not addressed the multitude of trial level decisions and other Court of Appeal decisions in Ontario and other jurisdictions that have touched upon the appropriate framework of analysis for calculating damages under incentive compensation plans. It would be wrong to say that Justice Feldman is alone in his view that the Pro rata approach should be adopted.

Mr. Manastersky is seeking leave to appeal the second Court of Appeal decision. A dissenting judgment can be a reason for the Supreme Court of Canada to consider the issues raised in the case. We will be monitoring the progress of the case over the next months.
