



## THE LEGAL PERILS OF LONG-TERM INCENTIVE PLANS

By **Jann Lee**

In 2010, David Styles moved to Alberta from Ontario to work as vice-president of relationship investments for the Alberta Investment Management Corp.

While the decision to uproot his life wasn't easy, Styles says the opportunity to earn a sizeable compensation, if he performed well, was a big draw. The majority would come from AIMCo's long-term incentive plan, which defers a portion of an employee's annual bonus and invests it in a phantom portfolio. The investment tracks the employee's portfolio, as well as the organization's overall performance, so the deferred bonus would grow along with the funds.

AIMCo awarded the annual bonuses as grants with a four-year vesting period, says Styles, noting the deferred amounts came to about \$100,000 a year. His funds performed well, so his grants also grew.

"I always assumed it was money I had earned and I just had to collect it on the fourth anniversary of a grant," says Styles.

But just a month after his three-year anniversary and before he was able to redeem his first grant, AIMCo fired Styles without cause. And while the employer awarded him a lump sum of \$49,162.50 to equal three months of salary, it refused to give him the proceeds of his unvested long-term incentive plan. The proceeds, including the investment returns, amounted to almost \$782,000, according to the proceedings in *Styles v. Alberta Investment Management Corp.*

Styles says he signed an agreement accepting the grants every year, because he believed he would eventually receive them once they were vested. But AIMCo's provisions for long-term incentive plans included the condition that an employee must be actively employed once the vesting period ends.

"The argument we made back was that AIMCo made it impossible for me to fulfil that piece of the agreement," says Styles.

In 2015, the Alberta Court of Queen's Bench ruled in Styles' favour and awarded him \$444,205 in damages. In her decision, Justice Debra Yungwirth referred to the Supreme Court of Canada's ruling in *Bhasin v. Hrynew*, which touched on an employer's duty to act in good faith in the performance of contractual obligations. "When an employment contract includes a condition for the receipt by an employee of a benefit under the contract and the employer has the discretion . . . it becomes even more important for that discretion to be exercised fairly, reasonably and not arbitrarily," wrote Yungwirth.

She noted that since Styles had fulfilled his obligations as an employee and exceeded every performance target, "the employer's contractual discretionary powers were not exercised fairly and reasonably in the circumstances."

Yungwirth's decision came as a shock to employers, as AIMCo's contract was clear that it would only release long-term incentive grants to employees if they were actively employed at the completion of the vesting period, says Gary Clarke, a partner at Stikeman Elliott LLP in Calgary. "That's the reason why it was horrifying. . . . The court found a way around that to essentially give the employee something the plan didn't contemplate they were to get," says Clarke.

"Styles kind of threw a wrench at things. . . . Employers were revising incentive plans in the wake of the decision to add additional language to make it even clearer there would be no entitlement over the reasonable notice period," he adds.

AIMCo, however, appealed the decision to the Alberta Court of Appeal, which reversed Yungwirth's ruling and found in the employer's

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favour earlier this year. It also rejected Yungwirth's application of the principle of reasonable exercise of discretion.

*Bhasin* doesn't establish that as a general principle, according to Justice Frans Slatter of the Alberta appeal court. "This radical extension of the law is unsupported by authority, and contrary to the principles of the law of contract."

The Court of Appeal applied a traditional approach and took AIMCo's plan language at face value, says Dave McKechnie, a partner at McMillan LLP. "It rightly said: 'You can't do that, you can't go beyond the terms of the plan.' If the terms are clear and properly implemented, then those are the terms and the court's job is to enforce them and not come outside and reward the employee."

But Styles says the initial ruling shows Canadian courts are becoming more open to looking at contractual agreements beyond black-and-white terms. He's now seeking to challenge the appeal court's ruling at the Supreme Court of Canada.

"I feel so strongly that what they did to me was so outrageous . . . I just want to have this on file that they can't do this sort of thing. How do you dangle this carrot in front of somebody? You get them to move and every day, you show them the carrot's getting bigger and bigger and just before he gets it, you yank it from him. It's completely unfair," says Styles.

### The role of incentive plans in employment disputes

While employment disputes do arise after a termination, Styles' case and another matter, *Lin v. Ontario Teachers' Pension Plan Board*, involve a unique type of employer — pension plans — that in many cases offer long-term incentive plans to investment managers and executives.

Over the years, pension plans have evolved their

compensation packages to attract and retain executive talent, notes Anand Parsan, senior vice-president of executive compensation at Compass Inc. "When pension funds first started, they used to just have annual bonus plans and a base salary. The problem with that is pension funds have more of a long-term horizon, because they're making long-term investments to meet the liabilities they have with pension plan members."

As a result, pension plans carved out long-term incentives that encourage employees to not only stay with the company but also to perform well, says Parsan.

But while long-term incentive plans offer some advantages, they also pose a risk if an employer doesn't draft them properly, says Clarke.


"Lots of times, [employers] entirely forget to address what happens when the employment relationship ends . . . Another common problem is, even if they do address termination, they don't clearly state the notice period won't be considered as active employment in any form for the purposes of the plan."

Indeed, Ontario Teachers' modified its long-term incentive agreement in 2010 to clarify that employees terminated with or without cause prior to the payout date wouldn't be eligible to receive the bonus, says McKechnie.

But when the pension plan asked employees to sign onto the new plan, many of them, including investment associate David Lin, refused to do so.

As a result, Lin received his long-term incentive payment, along with his salary and annual bonus, as part of the damages he received after the court ruled he was wrongfully dismissed, says McKechnie, noting the case offers a lesson for employers that want to change plan documents.

"In *Lin*, they sort of foisted [the new plan] on employees . . . What the court was critical about was, when employees refused to sign off on the new language about entitlements post-termination, the Ontario Teachers' didn't take the necessary steps to make sure the language was enforceable," says McKechnie.

Courts usually put the onus on employers to write clear and unambiguous contracts and, if they don't, rulings will likely favour employees, says McKechnie. "So employers have to be very careful and spend the time to look at all other employment agreements, plan documents, to ensure they're as clear as possible and the language they're using will actually be able to be enforced." 

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### DAVID STYLES' COMPENSATION DURING HIS TIME AT AIMCO

Salary:

**\$175,000**  
in 2010 and 2011

**\$190,000**  
in 2012

**\$196,650**  
in 2013

Annual incentive plan grants:

**\$241,500**  
for his work in 2011

**\$262,500**  
for his work in 2012

Long-term incentive plan grants awarded:

**\$110,000**  
on Jan. 1, 2011

**\$134,000**  
on Jan. 1, 2012

**\$127,800**  
on Jan. 1, 2013

Source: *Styles v. Alberta Investment Management Corp.*