

## **Bonus Season is Coming: Are You (And Your Documents) Ready?**

Each year companies reward their employees with payments under their “discretionary” bonus (or short-term incentive) programs. The intent of these programs is to incent and improve employee performance during the year with the outcome of paying bonuses reflecting annual performance.

While most employers characterize bonus programs as discretionary, implementation can result in these payments becoming an integral element of the employee’s compensation. And this can become a bone of contention when an employee leaves the organization, whether voluntarily or involuntarily.

A carefully drafted bonus program can assist employers in maintaining the discretionary nature of the programs and protecting the company from larger payouts on termination of employment.

### ***What’s the issue?***

You include wording in your employment agreements and offer letters that your bonus program is “discretionary”. Your bonus plan goes on to say that employees must be “actively employed” on the payment date to be eligible for the payment.

Over the past several years, the courts have been asked to confirm what these terms mean when employees are terminated and entitled to payment in lieu of notice of termination. Is bonus included in this payment?

First, courts will consider whether the bonus program is really discretionary. Has discretion actually been exercised historically or are payments made each year? Where annual payments are the norm, it is likely the bonus will be considered an integral part of the employee’s compensation. And therefore, must be included in a payment in lieu of notice of termination.

The matter is further complicated if a portion of the bonus is based on corporate performance and not employee performance. The corporate portion of the bonus becomes payable on a termination where corporate targets are being met, regardless of the reason for termination of the employee.

Employers seek to address these issues by including language in their bonus plans saying the employee must be “actively employed” on the date payment is made to receive it. Again, the courts have interpreted this wording to be insufficient to exclude bonus in a payment in lieu of termination where the bonus payment would be made during the reasonable notice period.

### ***So, what can companies do?***

The most recent decisions of the courts impose a two-part test to determine if a company has done enough to preclude damages for bonus from being included in a termination payment.

First, would the employee have been entitled to the bonus payment as part of their compensation during the reasonable notice period?

For example, a 10-year employee is terminated on November 1<sup>st</sup>. The reasonable notice period is determined to be 10 months and bonus is payable on March 31 of each year. In this case, the employee would be entitled to the bonus payment as it would have been paid during the 10 month notice period, which ends August 31. If the employee had 3 years of employment and the reasonable notice period is determined to be 4 months, a bonus payment on March 31 would not be included as March 31 is after the end of the reasonable notice period.

The second question is, do the terms of the bonus plan or agreement unambiguously limit or remove the employee's common law right to payment of the bonus in lieu of working notice?

This is a more difficult question to answer. The courts have been clear, merely saying an employee must be actively employed on the payment date is not sufficient to limit or remove the employee's right to payment of the bonus on termination. The employer's obligation is to give notice of termination and if they had done so, the employee may be actively employed when the payment date occurs. Recent decisions have found that more language is required in the employment agreement or bonus plan.

More specifically, employers are advised to add extra language to their bonus plans stating that the employees waive their right to any claim to a bonus, or a portion of it, if their employment is terminated on the day prior to the payment date of the bonus. Another option is to state that active employment does not include any notice period on termination of employment.

When making annual bonus payments, employers have the opportunity to clarify the language of their bonus plans in annual compensation letters, to protect the employer in the event of termination of their employees.

Canadian employers are well advised to seek legal advice when drafting bonus plans and entering into employment agreements. As experienced legal counsel, we can help you draft clear and unambiguous terms in plan documents and employment agreements and work with you to determine what, in your specific circumstances, is most effective and enforceable to protect the company.

Before you make your bonus payments for the 2023 performance year, our employment lawyers are ready and available to work with you.

Sources:  
Matthews v. Ocean Nutrition Canada Ltd. (SCC, 2020)  
Paquette v. TeraGo Networks Inc. (ONCA, 2016)

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After 25 years advising large companies as inhouse legal counsel, Carmelle Hunka has joined Walsh to bring her business and employment law experience and practical approach to our clients. Carmelle has extensive experience in all areas of employment law including policies and plan documents, employment agreements, executive compensation including public disclosure, incentive plans, terminations, human rights matters, ethics and business conduct matters including investigations and anti-corruption and anti-bribery matters, and advising companies regarding employment law matters in merger and acquisition activity.

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