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Beware the Perils of Firing Employee-Shareholders

By: Stephen Acker and Julia Kennedy

As we have repeatedly reported, courts may be finding new ways to put money in former employees' pockets. Another example is the Ontario Court of Appeal's recent decision in [Link v. Venture Steel Inc. and Ruben Rivas](#), where it agreed with the trial judge's decision awarding a former employee more than \$4 million in damages. Only \$550,000 of the damages was pay in lieu of notice. The bulk of the damages related to shares that had been improperly purchased by the employer at the time it terminated the employee's employment for cause.

The Shareholder Agreement

In 1996, William Link started setting up Venture Steel. Link was employed in a sales capacity. By 2005, when his employment was terminated for cause, Link was the Vice-President of Sales.

In 2004, the other defendant, Ruben Rivas, entered into a Shareholders' Agreement with Link and five other executives of Venture. Under the Agreement, Link received 90,000 common shares of Venture – about 9%.

The Shareholders' Agreement dealt with termination of employment. In the event of termination, the shareholder's shares could be purchased by Rivas. If the termination was without cause, the purchase price would be 100% of the net book value of the shares. With cause, however, the purchase price would be \$1.

Termination of Employment

When Venture fired Link, it alleged cause. It claimed that Link drank excessively, was dishonest, took secret profits and stole from the company. Venture eventually withdrew all but two of its allegations of cause. But not until the trial. As such, at the time of termination, Rivas purchased Link's shares for \$1.

After the Termination

Matters did not end at the termination. A year later, another company, Royal Laser, purchased Venture for \$43.5 million. As a result, Link's former shares were sold by Rivas to the new company.

The Trial

At trial, the judge said there was no cause for Link's termination. Instead, he was entitled to 12 months pay in lieu of notice. This amounted to approximately \$550,000. Interestingly, the court did not penalize Link for failing to mitigate his damages during those 12 months because of the effect of non-competition and non-solicitation clauses in the Shareholders Agreement that remained in effect for a year after he ceased to be a shareholder.

But the real damage was to come. Because there was not cause, Rivas could not properly have purchased Link's shares for \$1. As a result, the court said Link still owned his shares when Rivas sold the shares to Royal Laser for \$42.5 million. As such, he was entitled to participate in the profits of that sale. That amounted to more than \$3.2 million – or 9% of the purchase price, less deductions. Link was also entitled to 9% of a dividend that was paid – another \$230,000 – and interest on the value of the shares covered by an option agreement – another \$530,000.

The Appeal

Venture appealed the decision. The Court of Appeal agreed with the bulk of the trial decision and said:

- Link was entitled to participate in the profits of the sale to Royal Laser. Link was never paid \$1 for his shares. And Rivas and the other selling shareholders could not have excluded Link from the sale proceeds but for the wrongful actions of Venture and Rivas. The only caveat was that Link had to surrender his shares before collecting the \$3.2 million.
- Link was not entitled to 9% of the dividend that was paid. In order to be entitled he would have had to exercise his option to purchase shares, which could not be exercised given the termination of his employment.
- The trial judge was correct in not making a deduction for failure to mitigate. Venture led no evidence about the availability of suitable employment – so could not show that Link acted unreasonably.

Lessons Learned

Once the court determined that there was no just cause to fire Link, every decision Venture made in relation to Link's shares became invalid. Before pursuing share transactions based on a just cause termination, a company should have an airtight case to support its allegations. The consequences of being wrong about the termination can mean owing millions if these transactions are invalidated by the court.

While this is an Ontario decision, it could have persuasive value across the country. Just cause is a tough card to play. Building a house from a deck of such cards can lead to crumbling results.

For more information on the subject of this bulletin, please contact the authors.

Stephen Acker

613 236 3882
sacker@fasken.com

Julia Kennedy

613 236 3882
jkennedy@fasken.com

Contacts

VANCOUVER

Kevin P. O'Neill

604 631 3147
koneill@fasken.com

Charles G. Harrison

604 631 3132
charrison@fasken.com

CALGARY

Katie Clayton

403 261 5376
kclayton@fasken.com

TORONTO

Karen M. Sargeant

416 868 3475
ksargeant@fasken.com

Brian P. Smeenk

416 868 3438
bsmeenk@fasken.com

OTTAWA

Stephen B. Acker

613 236 3882
sacker@fasken.com

MONTRÉAL

Dominique Monet

514 397 7425
dmonet@fasken.com

Dominique Launay

514 397 5240
dlaunay@fasken.com

QUÉBEC CITY

Jasmin Marcotte

418 640 2030
jmarcotte@fasken.com

LONDON

Cerys Williams

+ 44 207 917 8955
cwilliams@fasken.co.uk

PARIS

Anne Granger

+33 1 44 94 96 98
agranger@fasken.com

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