

Termination for Cause in the United States: It's Whatever You Want it to Be

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by Aaron Goldstein

The default rule in most U.S. states is at-will employment. This means that either the employee or the employer may terminate the employment relationship at any time, without notice, for any reason—other than a discriminatory or retaliatory reason. A reason is discriminatory if it is based upon an individual's status as a member of a protected class, such as race, gender, national origin, or religion. A reason is retaliatory if it relates to an individual's protected activity, such as whistleblowing or raising concerns regarding the terms and conditions of employment.

Parties can opt out of the default at-will rule by entering into an employment agreement that provides the employee with severance unless the employee is terminated for "cause" or quits without "good reason." Unlike Canada, which has a rich body of law explaining what does and does not constitute "cause," it is completely up to the parties in the United States to decide what constitutes cause and put that definition into the employment agreement. Getting this definition right is extremely important, and Canadian companies with employees in the United States that do not pay close attention to such language might be stuck paying substantial severance to employees whom they would have a right to terminate for cause under Canadian law.

Most U.S. employment agreements for high-level employees provide for severance benefits ranging from a few months to a few years of pay upon the termination of employment if the company terminates the employee without "cause" or the employee quits for "good reason" as defined in the employment agreement.

The definition of "cause" can vary widely from agreement to agreement and is often the subject of intense negotiation between the company and the employee. Many agreements only allow the company to terminate for cause if the employee engages in extreme misconduct, such as a felony or an act of dishonesty that has a substantial negative impact on the company. Other agreements allow the company to terminate for cause if the employee fails to competently perform the employee's job duties. Often times, the agreement will require that the employee be given notice and an opportunity to

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cure any failure that would otherwise constitute cause for termination.

Some but not all agreements also allow the employee to quit and receive severance if the employee quits for “good reason” as defined in the employment agreement. “Good reason” is often defined to include a material reduction in the employee’s duties or compensation, or a requirement that the employee relocate. Good reason may also be tied to a change in control over the company, such that the employee’s right to quit for good reason and receive severance only arises if the company changes ownership.

Canadian companies purchasing U.S. businesses can find themselves hamstrung by definitions of “cause” and “good reason” that make it very difficult to fire or even control wayward executives that were brought along as part of the deal. Cause definitions that require extreme misconduct by the executive tie the company’s hands in situations where the executive is merely performing poorly or not following the board’s directives. Good reason definitions that allow an executive to quit if the executive’s duties are changed or curtailed make it difficult to put new management in place where the executive and the board fail to see eye-to-eye on how the company should be run.

U.S. courts tend to give the benefit of the doubt to the employee when assessing whether cause or good reason exists under an employment agreement, and companies that want to retain the right to terminate an employee for poor performance without paying severance should make sure that poor performance is explicitly included in the definition of cause. Alternatively, if a company is agreeing to a very employee-friendly definition of cause, it should be prepared to pay out the severance provided for in the employment agreement in all but the most extreme cases of employee misconduct.

Business acquisitions usually start with the best of intentions and goodwill between the parties. No one goes into such a deal expecting it to go sideways. However, it is very important that Canadian companies looking to take on U.S. employees know what they are getting into in terms of severance obligations—and negotiate definitions of “cause” and “good reason” that reflect the company’s expectations.