

# FACTSHEET: SEVERANCE PAYMENTS

**Termination of your employees is a complex area. The law is often not 100% clear and interpretations of the law can change following court decisions. This section of the Employers' Guidebook sets out the current situation and is intended to give general guidance rather than legal advice. As termination of employment is the main reason why disputes between employers and employees arise, if you are terminating staff and are not sure of procedures we strongly recommend seeking advice from a labour officer, a more experienced employer or a lawyer.**

Severance payments are of particular interest to employers recently since amendments to legislation in 2009. The application of this change to the law is still being established through practice and case law.

This factsheet sets out the current situation on severance payments and is intended to give general guidance rather than legal advice on this emerging area of the law.

## 1. WHEN IS AN EMPLOYEE ELIGIBLE FOR SEVERANCE ALLOWANCE?

For an employee to be eligible for a severance payment she must have been in **continuous employment** with the employer for 12 months, and her contract must come to an end in one of the following ways:

- the employer terminates her employment (section 54(1)(a)); or
- the employee retires or is retired by the employer on or after reaching the age of 55 years (section 54(1)(b)&(c)); or
- the employee resigns after working for **6 years** (section 54(1)(d)); or
- the employee is unable to continue work due to illness or injury and this is certified by a registered medical practitioner (section 54(1)(e). Whilst the death of an employee is not specifically mentioned it would also fall under s 54(1)(e). to be unfit to continue to work.

To be in **continuous employment** an employee must work for 4 or more days per week (section 54(2)(a)). There are no minimum hours that the employee must work. The law is silent on whether unpaid absences from work for reasons such as study leave or secondment to a different employer count towards a period of continuous employment. If this is a situation you are likely to encounter you should include provisions in your employment contract to clarify this.

There is **no obligation** to pay severance allowance if the employee is terminated for **serious misconduct** (section 55(2)).

There is also **no obligation** to pay severance allowance to employees who are **recruited from outside of Vanuatu and are not ordinarily resident in Vanuatu** (section 55(1)). The Court of Appeal has held that an expatriate who was initially recruited outside of Vanuatu but then has gone on to renew successive contracts and has become ordinarily resident in Vanuatu will be entitled to severance allowance (*Air Vanuatu (Operations) Ltd v Molloy* [2004] VUCA 17).

## 2. DOES EXPIRY OF A FIXED TERM CONTRACT COUNT AS TERMINATION BY THE EMPLOYER?

GREY AREA: The Court of Appeal has held that for an employer to allow a contract to expire is termination by the employer for the purposes of section 54(1)(a). In this situation severance allowance is payable (*Air Vanuatu (Operations) Ltd v Molloy* [2004] VUCA 17). However a recent Supreme Court decision has said that expiry is not a termination by anyone, but is instead a termination due to time, and in this situation severance allowance is not payable (*Supa v Vanuatu Plant Hire* [2010] VUSC 166 [para 17]).

Whilst Court of Appeal decisions are given more weight in law, and it is likely that expiry of a contract counts as a termination by the employer, in which case severance allowance is payable, this point is not settled.

### 3. IF I SELL OR TRANSFER MY BUSINESS TO ANOTHER PERSON AND MY STAFF CONTINUE WORKING FOR THE NEW PERSON WHAT HAPPENS TO SEVERANCE ALLOWANCE?

If a business comes to an end and the employee is offered and accepts employment under the same or more favourable conditions then the new employer assumes liability for severance allowance from the time that the employee started with the original employer (section 55(5)).

- A business is sold as an ongoing concern and the new owner offers employment (section 55(3)(d))
- A partnership is dissolved and either a new partnership is formed or a member of the dissolved partnership offers employment (section 55(3)(b))
- A company is dissolved and restructured and the employee is offered employment in the new company (section 55(3)(c))
- An employer dies and the personal representative of the deceased offers (section 55(3)(a))

It is possible for the original employer to terminate the employment of staff on open ended contracts by giving notice. If any employees engaged on fixed term contracts have notice clauses in their contracts they can also be terminated by notice. The original employer is liable to pay severance allowance owed at the time of termination. The new employer can then enter a new employment contract. Other arrangements, such as a reduction in sale price to allow for severance allowance obligations, are, of course, possible.

It is recommended that, as part of any sale or transfer of business, obligations in respect of severance allowance for any employees being transferred is clarified.

*In December 2011 Bizniz bought a tour business that had 4 staff working for it. All staff had worked for the business for since December 2009 and continued to work for Bizniz. In December 2013 one staff member resigned. How many years of severance allowance does Bizniz have to pay?*

In this situation the employees are in continuous employment and all liabilities in respect of staff severance allowance transfer to Bizniz. Unless the employees had their severance allowance for 2009 - 2011 paid out by the original business owner in December 2011 Bizniz is required to pay severance allowance from the time the staff member starting working in the business, **not** from the time that Bizniz took over the business.

### 4. HOW IS SEVERANCE ALLOWANCE CALCULATED?

Severance allowance is calculated at the rate of 1 month's remuneration per full year worked. **For any partial years worked** a pro rata payment ( $1/12 \times 1 \text{ month salary} \times \text{number of months worked}$ ) is payable (section 56(2)). The salary is based on what is paid at the time of termination (section 56(7)).

*Jenny worked for Bizniz for 4 years and 3 months. At the time of her termination she was being paid a salary of 120,000 vatu per month. How much severance is Jenny owed?*

For each full year Jenny is owed: 120,000 vatu (1 month's salary).

For extra months Jenny is owed: 10,000 vatu ( $120,000 / 12$ ).

The full calculation is  $(120,000 \times 4) + (10,000 \times 3) = 510,000$  vatu.

Where payment varies depending on the amount of work done, or includes a commission component payment shall be based on the average payment received over the 12 months immediately preceding termination (section 56(3)).

*As a real estate agent Bizniz Real Estate employs sales staff on commission only basis. Because business has been poor over the last six months Bizniz wants to lay off Emma, who works as a Sales Agent. Emma has worked with Bizniz Real Estate for the last two years. She earned 8 million vatu in total commissions in her first year In her second year she only earned 2,100,000 vatu in total in commissions. How does Bizniz work out what Emma's severance pay should be?*

The rate of severance is based on the average pay to over the last year. Here is a worked example:

Although Emma earned a very large commissions in her first year as these were not earned in the last 12 months they do **not** count when calculating severance pay.

Commissions over the last 12 months are 2,100,000 vatu

Divided by 12 this gives Vatu 175,000.

As Emma worked for two years then the total severance payment will be 350,000 vatu (2x 175,000).

**GREY AREA:** Case law has said that remuneration only includes money paid as salary or wages. It does **not** include allowances such as housing allowance or travel allowance (*Banque Indosuez Vanuatu Ltd v Ferrieux* [1990] VUCA 3). However, some cases do include allowances such as housing allowance as remuneration for the purposes of calculating severance allowance (See, for example, *Benard v Republic of Vanuatu* [2012] VUSC ). Separating different components of total payment into wage or salary remuneration and other allowances and stating in employment contracts that severance allowance is calculated on the basis of wage or salary remuneration **may** help to clarify this.

*Bizniz knows the law changed in October 2009, and severance allowance only used to be ½ a month's salary. Can Bizniz pay the employee severance at a rate of ½ a month's salary for the years worked prior to October 2009?*

No – severance allowance is calculated using 1 month's salary per year worked, from the time the employee started continuous employment. This matter was taken to the Court of Appeal and is now settled (*Wilco Hardware Holdings Ltd v Attorney General* [2013] VUCA 12).

## 5. ARE THERE ANY DEDUCTIONS I CAN TAKE FROM SEVERANCE ALLOWANCE?

Deductions that can be taken from the severance allowance are found in section 57.

Where an employee retires, or is retired, on reaching the age of 55 the employer may deduct:

- half the amount of any gratuity due at the age of 55 years from any pension fund **other than VNPF**
- any gratuity granted at the age of 55 years by the employer
- 5 times the amount of any annual pension granted at the age of 55 years from any pension fund **other than VNPF**
- 10 times the amount of any annual pension granted at the age of 55 years by the employer

**Pension fund** is defined to mean any provident or pension fund or similar scheme other than the Vanuatu National Provident Fund which is specifically approved by the Commissioner (section 57(2)).

Where employment ends in a situation other than retirement, the employer may deduct:

- any gratuity granted by the employer;
- any contribution made to any pension fund other than VNPF

GREY AREA: It is not clear if gratuities such as Christmas bonuses can be deducted from severance allowance. Case law has said that, in a case where the only gratuity that can be deducted is a gratuity paid at the time of termination (*Mouton v Selb Pacific Ltd (Judgment #3)* [1998] VUCA 8).

Case law has also said that 'there is no barrier in law or in principle which restricts the ability of an employer and an employee to make their own private arrangement with regard to a severance entitlement providing it does not in any way undercut or minimize the employee's entitlements' to severance allowance (*Air Vanuatu (Operations) Ltd v Molloy* [2004] VUCA 17).

It **may** be possible to deduct gratuities such as Christmas bonuses if they are clearly stated, in writing, to be considered advance payments on severance allowance due at the end of the contract. It would clearly be possible to manage severance allowance by saving gratuities such as Christmas bonuses for the employee and paying them all out at the end of the contract.

A contract that pays severance allowance monthly along with salary **may** be allowed to replace severance allowance obligations if it clearly provides a more favourable benefit to the employee than the employee would be entitled to under the severance allowance provisions of the Employment Act (*Air Vanuatu (Operations) Ltd v Molloy* [2004] VUCA 17). The wording of the employment contract would need to be very clear.

*In the past Bizniz paid performance bonuses of up to 20% based on sales volumes to my salesmen. Now Bizniz has hit a rough patch, and needs to terminate several members of its sales force. Will Bizniz have to include these bonuses in any severance calculations for these salesmen?*

Probably not if these are presented as performance based additions on top of their salaries. However it will depend on the contract wording if these bonuses could be reasonable expected to be earned by the Bizniz salesforce. We recommend obtaining legal advice to determine if severance payments are payable in this circumstance.

## 6. HOW CAN I MANAGE SEVERANCE ALLOWANCE SO THAT I CAN AFFORD IT WHEN EMPLOYEE'S EMPLOYMENT COMES TO AN END?

As discussed in the grey areas, above, you may be able to pay gratuities throughout the contract, or structure your contract so that you pay a severance allowance directly to the employee monthly. These methods of managing severance allowance are uncertain, however.

There are some other practical measures you can take. These include:

- Keeping a savings account for severance liabilities, and depositing an amount to cover future severance liabilities into it each month, so that you have money saved.
- Getting a pension plan other than VNPF approved by the Commissioner of Labour, and paying into this every month, so that you can deduct most, or all, of this amount from severance allowance payable at the end of the contract.

These management strategies may be of limited use if the law on severance changes.

Some employers use fixed term contracts and pay out severance at the end of each contract, then reemploy the employee on a new contract so that the amount of severance allowance does not build up. This is something of a **grey area** and has not been fully tested in court.