Drafting Enforceable Termination Clauses

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Outline of Presentation

• The importance of written employment contracts
• Implementing written employment contracts
• Modifying written employment contracts for existing employees
• Termination Clauses
• Different approaches to termination provisions
• Recent case law on termination provisions
Importance of Written Employment Contracts
Benefits of Written Employment Contracts

• Modify terms that will otherwise be implied by law
• Create contractual terms that will not otherwise be implied by law
• Provide certainty to the parties
• Allow for predictable termination costs
Modify Terms Implied by Law

• Canadian common law will imply certain terms into employment contracts

• Duty to provide reasonable notice of termination will be “read into” an employment contract by the courts unless it is otherwise expressly addressed in the contract itself.
Create Contractual Terms that Will not Otherwise be Implied by Law

• Creating a written employment contract allows an employer to modify terms implied by law and to create contractual terms that would not otherwise be implied by law

• Terms that will not be implied by law:
  – Probationary period
  – Right to temporarily lay off employees
  – Non-competition / non-solicitation obligations
Provide Certainty to the Parties

• Written employment contracts provide a clear written record of the parties’ agreement that can be referred to at a later date in the event of a dispute.

• They avoid later reliance on verbal agreements or conversations, the details of which can be lost or misconstrued over time.

• Properly drafted, written employment contracts can avoid uncertainty as to which terms are truly contractual.
Predictable Termination Costs

• Common law reasonable notice is calculated based on an employee’s age, length of service, position and chances for re-employment
  – Only exceptional cases reward more than 24 months
  – Can be very generous for older, longer service, senior employees
  – Tends to be disproportionately high for short service employees
  – Precedent cases provide ranges of reasonable notice; not certainty
Predictable Termination Costs

- Properly drafted termination clauses in employment contracts can reduce the amount of notice owing to an employee.

- Contractual formulas can “grow over time” with an employee’s service.

- Must provide a benefit that is at least equal to, or greater than, employment standards minimums.
Implementing Written Employment Contracts
Requirements for an Enforceable Contract

• An employment contract is no different than any other contract in that it requires offer, acceptance and consideration

• Consideration = something of value pledged in exchange for agreeing to be bound by the contract
  – For new employees, consideration is the initial employment itself with its attendant compensation
Implementing Written Employment Contracts

- Make the signing of the employment contract a term and condition of the offer of employment

- Ensure that all policies, procedures and ancillary documents are incorporated into the employment contract

- Allow the applicant sufficient time in advance of the start date to review and consider the contract and to obtain advice (legal or otherwise)

- Do not let the applicant “sign on the spot”

- Offer the applicant the opportunity to ask questions

- Ensure that the applicant “signs back” the employment contract prior to starting work
Modifying Written Employment Contracts For Existing Employees
Legal Risk - Constructive Dismissal

• An employer cannot unilaterally make substantial changes to an employee’s terms and conditions of employment which amount to a fundamental breach of contract without providing reasonable notice.

• Damages for constructive dismissal = damages owing in the event of a termination without cause.

• Examples of a “fundamental breach”:
  – 15% reduction in compensation
  – Significant demotion
  – Transfer to a far-away location
  – Creation of an “intolerable” work environment
  – Significant reduction in termination entitlements.
Avoiding Constructive Dismissal

1. Provide “fresh consideration”

2. Provide employee with written notice of the change
Provide “Fresh Consideration”

• Changes can be implemented in an offer of continued employment

• Ensure that the employee receives fresh consideration in exchange for signing new offer and refer to that consideration in the contract (e.g. promotion, salary increase, signing bonus, new form of compensation or benefits)
  – E.g. NOT a regular annual salary increase

• Give employee time to review and seek advice

• Review any key changes with the employee (and retain proof that you did so)
Provide Employee with Written Notice of the Change

• How much advance notice is required?
  – Individual analysis
  – Equivalent to the amount of notice that would otherwise be owing to the employee in the event of a termination without cause

• If the change impacts several employees…
  – Prudent approach is to give every employee the amount of notice that corresponds to the longest period of notice that would be awarded to any one of the individual employees
• An employee has three choices in response to an employer’s written request to impose a fundamental change:

1. Accept the change
2. Refuse the change and sue for constructive dismissal
3. Refuse the change and continue working
• If the employee chooses option 3 and continues to work, the employer may:

1. Accept the employee’s refusal and allow him or her to continue working under the original terms and conditions
2. Terminate the employee with proper notice and offer the employee re-employment on the amended terms
Termination Clauses
Termination: Just Cause

• Confirm that the employment relationship can be terminated for just cause without notice or pay in lieu of notice

• Common examples:
  – Theft or fraud
  – Conflict of interest
  – Workplace violence / harassment
  – Breach of confidentiality obligations
  – Serious workplace safety violations
  – Any other misconduct which would constitute just cause at law
Termination: Just Cause

• “Capital Punishment of Employment Law”

• Misconduct must be just cause at law to begin with

• Burden on employer is high

• Progressive discipline with culminating incident vs. single offence
Termination: Without Cause

• Contracting out of common law reasonable notice: Machtinger v. HOJ Industries, [1992] 1 S.C.R. 986

  – Employers can displace/rebut the implied obligation to provide common law reasonable notice in the event that an employee is terminated without cause

  – It is permissible for an employer to limit an employee’s entitlement to only the minimum payments under employment standards legislation
Termination: Without Cause

• Termination provisions that do not meet employment standards minimums at the time of termination are void *ab initio*

• The same is true if the termination provision could, at any given point in time, violate employment standards minimums
  – E.g. (Ontario). Termination provision provides for two weeks’ notice or pay in lieu of notice per year of completed service. No further entitlements.
  – Provision = void.
Termination: Without Cause

• *Wright v. Young & Rubicam*, 2011 ONSC 4720 (at para. 36):
  – “There is, in my view, no particular difficulty in fashioning a termination clause that does not violate either the minimum standards imposed by the *Employment Standards Act* or the prohibition against waiving statutory minimum requirements and there is no compelling reason to uphold a termination clause which the draftsman may reasonably be understood to have known was not enforceable either at all or under certain circumstances.”
Properly Dealing with Resignations

• Important Distinction…
  – Date on which the employee provides notice of resignation
  – The effective date of resignation

• Caution: a resignation can become a termination
  – E.g. Employee provides two months' notice of resignation
  – Employer asks employee to leave immediately and stops compensating the employee
  – Resignation was not accepted on terms it was offered
  – Result is a termination of employment
  – Employee is entitled to all for his or her entitlements under contract or at common law, as applicable
Properly Dealing with Resignations

• Address the issue in the written employment contract:
  – E.g. “If you resign from your employment, you agree to provide [EMPLOYER] with at least two weeks’ prior written working notice. [EMPLOYER] has the right to waive a portion or all of the notice given by you and to direct you not to report for work for any part of the notice period. In such case you will be paid up to a maximum of two (2) weeks’ notice, less required deductions, and the [EMPLOYER] will have no further obligations to you.”
Approaches to Termination Provisions
Three Approaches to Termination Provisions

1. Statutory entitlements only:
   - No ambiguity
   - Address benefits
   - Address severance pay
   - All-inclusive
Three Approaches to Termination Provisions

2. Formula Approach (e.g. 2 weeks per year of service):
   - Cap entitlement?
   - Require Release?
   - Lump Sum or periodic payments?
   - Roll back in the event of mitigation?
Three Approaches to Termination Provisions

3. **Set Amount (e.g. 12 months)**
   - Consider probationary period
   - Require Release?
   - Lump Sum or Periodic Payments?
   - Roll Back in the event of mitigation?
Termination: Without Cause

- Best practices for drafting termination clauses:
  - Clear and unambiguous
  - Notice, pay-in lieu of notice, or a combination of both
  - Flat amount or a formula that grows over time (with or without a cap)
  - Lump-sum or salary continuance (clawback?)
  - Calculation of payments – what is included?
  - Benefit continuation
  - Mitigation
Best practices for drafting termination clauses:
- Notice and/or payments are inclusive of any and all entitlements to notice, pay in lieu of notice, benefits and severance pay under statute, contract or common law
- Saving provision → In all cases, entitlements will not fall below employment standards minimums
- If offering more than employment standards minimums, consider requiring a Full and Final Release for amounts over and above the minimums
Addressing Compensation During the Notice Period

- At common law an employee is entitled to all compensation and benefits that he or she would have otherwise received if he or she continued to work during the period of reasonable notice
  - E.g. Bonus, commissions, etc.

- If an employer wishes to restrict payment to “base salary only”, it must specifically state this in the termination provision and policies must allow for it
  - E.g. No right to earn any bonus, commissions beyond the end of the statutory notice period
  - Ensure consistency with employer plans
Recent Case Law on Termination Provisions
The employment agreement provided the following term:

- The term of this Agreement commences July 28, 2014 and ends on March 31, 2015 ("Term"). The term is for an eight (8) month period commencing July 28, 2014, and either party may terminate this employment contract upon thirty (30) days prior written notice to the other party, on a without cause basis". 
The plaintiff took the position that the provision allowing for termination prior to March 31, 2015 on thirty days' written notice violated section 54(a) and section 57(h) of the ESA. As a result, the entire paragraph should be struck from the employment agreement.

The judge concluded that the fixed term provision of the employment agreement was not null and void pursuant to the ESA.
The plaintiff also argued that the employment agreement as a whole was invalid because of its failure to incorporate essential provisions of the ESA.

The judge rejected the argument and stated:

- “The ESA provides for a large number of minimum conditions […]. Obviously, a provision purporting to deny severance pay where it is otherwise payable under the ESA would be null and void, but that argument cannot extend to nullifying a contract that fails to state that the law will be complied with. The ESA provides minimum standards which the parties are required to comply with. A contract that fails to list all such requirements -- as few indeed do -- is guilty only of preserving trees from unnecessary destruction. A provision which seeks to contract out of the law is unenforceable; a provision which merely promises to obey it is superfluous.”
The employment agreement provided the following terms:

- **9.2** Termination and contractual rescission: This agreement may be terminated without notice or compensation by CFT for the reasons mentioned in article 4 of this agreement. The CFT may also terminate this agreement for any other reason by giving the employee 15 days' notice or the minimum prescribed by *the Employment Standards Act* or by paying an amount of salary equal to the salary the employee would have had the right to receive during the notice period (after deduction and/or withholding at source), in the entire discretion of CFT.

- **12.2** If any of the provisions of the present agreement is invalid or unable to be performed by virtue of any law, regulation, order or any other requirement or other principle of law, this modality shall in such case be considered to be modified or nullified, but only to the extent necessary to comply with the statute, regulation, order, legal requirement or principle and the other dispositions of the present agreement shall remain in force.
The plaintiff argued that the termination provision was void because it could be viewed as permitting the defendant to provide only 15 days’ notice, and not severance, whereas the ESA requires greater notice.

It was argued that the reference to the shorter notice period was ambiguous or alternatively a disguised attempt to contract out of the minimum standards of the ESA.
Court upheld the enforceability of minimum standards-only termination clause.

There was no intent to contract out of the ESA.

The court’s principal reason for holding the clause enforceable was that article 12.2 operated to save article 9.2 from any inconsistency with the ESA.
The court was called upon, on a motion for summary judgment, to interpret the following contractual termination provision:

- The Company’s policy with respect to termination is that employment may be terminated by either party with notice in writing. The notice period shall amount to one week per year of service with a minimum of four weeks or the notice required by the applicable labour legislation.
Cook v Hatch Ltd., 2017 ONSC 47

- The termination clause in Cook did not expressly reference benefits continuation.

- The clause also did not contain language which expressly limited the employee’s entitlements to those contained within the agreement.
Counsel for the employee advanced two common arguments in support of striking out the termination provision:

1. the use of the phrase “applicable labour legislation” was ambiguous as it failed to specifically identify the Ontario Employment Standards Act, 2000 as the legislation applying to the termination; and

2. By failing to specifically reference the employee’s entitlements to severance pay and benefit continuance under the ESA, the clause attempted to contract out of the minimum statutory entitlements and was therefore void.
• The Court rejected both arguments and upheld the enforceability of the termination provision on the basis that the intention of the parties was clear.

• It is not necessary to refer to specific legislation in order to correctly and validly limit termination entitlements to the applicable legislation.

• Re-affirmed that “silence” with respect to severance pay or benefit continuation is not fatal to the enforcement of a termination provision.
Wood v. Fred Deeley Imports Ltd., 2017 ONCA 158

The court was called upon to interpret the following contractual termination provision:

[The Company] is entitled to terminate your employment at any time without cause by providing you with 2 weeks’ notice of termination or pay in lieu thereof for each completed or partial year of employment with the Company. If the Company terminates your employment without cause, the Company shall not be obliged to make any payments to you other than those provided for in this paragraph, except for any amounts which may be due and remaining unpaid at the time of termination of your employment. The payments and notice provided for in this paragraph are inclusive of your entitlements to notice, pay in lieu of notice and severance pay pursuant to the Employment Standards Act, 2000.
Wood v. Fred Deeley Imports Ltd., 2017 ONCA 158

The Court of Appeal began its analysis by addressing a number of considerations relevant to the interpretation and enforceability of a termination clause:

- Employees usually have less bargaining power than employers when employment agreements are made;
- Many employees are likely unfamiliar with the employment standards in the ESA;
- The ESA is remedial legislation, intended to protect the interests of employees;
- Termination clauses should be interpreted in a way that encourages employers to draft agreements that comply with the ESA;
- A termination clause will rebut the presumption of reasonable notice only if its wording is clear; and
- Faced with a termination clause that could reasonably be interpreted in more than one way, courts should prefer the interpretation that gives the greater benefit to the employee.
Wood v. Fred Deeley Imports Ltd., 2017 ONCA 158

• Counsel for the employee argued that the termination clause contravened the ESA because it failed to satisfy the employer’s obligation to continue benefits during the notice period.

• The employee also argued that the provision failed to satisfy the employer’s obligation to provide severance pay.
Counsel for the employer argued that the requirement to continue benefit plan contributions could be read into the clause: the word “pay” was broad enough to include both base salary and benefits.

The Court of Appeal rejected this argument, noting that at best the language was ambiguous and, as such, the language should be interpreted in favour of the employee.
Wood v. Fred Deeley Imports Ltd., 2017 ONCA 158

• The employer also argued that what it paid the employee on termination was relevant to the enforceability of the termination clause.

• The Court of Appeal dismissed this argument as well.

• The Court noted that if employers could always remedy illegal termination clauses by making payments to employees on termination of employment, employers would have little incentive to draft legal and enforceable termination clauses at the beginning of the employment relationship.
Wood v. Fred Deeley Imports Ltd., 2017 ONCA 158

• The Court also considered the argument that the clause contravened the ESA because it did not satisfy the employer’s statutory obligations to pay severance pay.

• Because the clause was drafted to provide that the notice entitlement was inclusive of the employee’s notice and severance entitlements, the clause could be interpreted in a way that would permit the employer to give the employee working notice only, and not severance.

• It would not be clear to the employee at the time she signed her employment agreement whether or not she would receive her statutory severance pay if her employment ended.
Nemeth v Hatch Ltd., 2017
ONSC 1356

• The court was called upon, on a motion for summary judgment, to interpret the following contractual termination provision:
  – The Company's policy with respect to termination is that employment may be terminated by either party with appropriate notice in writing. The notice period shall amount to one week per year of service with a minimum of four weeks or the notice required by the applicable labour legislation.

• The termination clause is silent as to severance and benefits.
At the outset the judge noted that this case was virtually identical to *Cook v. Hatch Ltd.*

Judge found no reason to divert from the views expressed in *Cook v. Hatch Ltd.* and dismissed the motion for summary judgment.

The termination clause did not reveal an intention to provide anything less than called for in the applicable employment standards legislation.

The termination clause was not ambiguous.

Judge highlighted that there must be a clear intention to avoid the terms of the legislation in order for the termination clause to be void.
Key Takeaways

• When drafting ESA-only termination provisions:
  – Don’t refer to the payment of “salary” and instead use the term “remuneration” or “pay in lieu of notice.”
  – Address all of the employee’s entitlements under the ESA including notice, benefit contributions and severance; it should not be limited to notice.
  – Put a cap on the employee's entitlements.
  – The clause should not contain language that could be read to oust other obligations under the ESA.
  – Although courts have held, in certain instances, that a clause without reference to the applicable statute can still be enforceable, reference to the ESA should be included in the clause for Ontario-only employers.
  – Include a saving provision.
Questions?
Thank You

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