Employment Termination Clauses: Another One Bites the Dust

By Landon Young and Frank Portman

Employers are increasingly using termination of employment clauses in employment offers and contracts to reduce the liability they face when terminating employees. This has been in reaction to increasingly generous awards from the courts. In turn, the courts have been holding such clauses to a higher level of scrutiny in recent years with the result that many of these clauses have been found to be unenforceable.

The recent case of **Wood v. Fred Deeley Imports Ltd** ("**Wood v Deeley**") from the Ontario Court of Appeal is the latest example of a termination clause that was struck down as unenforceable. The result was that the employee was held to be entitled to pay in lieu of reasonable notice of termination under the common law. Although the result was unfavourable for this employer, the case is instructive for employers about how to prepare a termination clause will be enforced.

Backgrounder on Termination Clauses

An employer and employee are free to negotiate what the employee's entitlements will be upon termination of employment provided the agreement does not provide less than the minimums required by applicable employment standards legislation. In Ontario, this is the Employment Standards Act, 2000 (the "ESA").

An employee is typically entitled to reasonable notice of termination under the common law, or pay in lieu, absent a specific term in an employment agreement regarding the employee's termination entitlements. The common law is a body of law that has been developed by court decisions over many decades. Unlike the ESA, an employer and employee may contract out of the common law.

If the employer and dismissed employee cannot agree upon the employee's entitlements after termination, the employee may sue for pay in lieu of reasonable notice. If the case does not settle, the court will decide what amount of notice the employee should have received as "reasonable notice" and how much the employee should receive as pay in lieu of that notice.

"Reasonable notice" is not determined by a formula, but by several factors that are weighed by the courts. The courts have broad discretion to determine the notice period and the results between similar cases can sometimes be inconsistent. Thus, litigation is common following the dismissal of an employee who is entitled to reasonable notice under the common law.

A well drafted termination clause can save both the employer and employee money on legal costs and reduce the uncertainty for both sides as to what the employee will be entitled to on termination. But a termination clause may also provide considerably less for the employee than what a court might award for reasonable notice under the common law. This, along with the potential savings in litigation costs and uncertainty, makes them attractive to employers. However, to achieve these

savings and certainty, the termination clause must be well drafted and avoid the possibility of falling below an employee's minimum entitlement under employment standards legislation.

Wood v Fred Deely Imports Ltd.

In **Wood v Deeley**, the litigation revolved almost exclusively around whether the termination clause complied with the ESA or was unenforceable. The clause (the "Termination Clause") read as follows:

> [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…. 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.

The motion judge on a summary judgment motion dismissed the Plaintiff's claim and found that the clause was enforceable.

However, the Court of Appeal disagreed on appeal and found that the Termination Clause was unenforceable because it fell below the minimum requirements of the ESA. The Court of Appeal found that the Termination Clause excluded benefits continuation from the employee's entitlements on termination because it did not require expressly for any payments beyond what was set out in the Termination Clause itself.

The Court of Appeal also found that, even if there were an ambiguity in the contract about whether benefits would be continued through the ESA notice period, that could not save it. For a termination clause to be enforceable, it must be in "clear, unambiguous language." Thus, if the Termination Clause could be read to exclude benefits continuation, the clause could not be relied upon by the employer to avoid reasonable notice under the common law.

The Court of Appeal also found that the Termination Clause fell short of the requirements of the ESA by failing to require severance pay (when/if applicable) to be paid out. Severance pay under the ESA, if the employee qualifies for it, cannot be avoided by giving the employee working notice of termination. If working notice were all that was given, then the Termination Clause could read as taking away the employee's right to severance pay under the ESA.

Takeaways for Employers

Employers who use termination clauses that could in any way be read as falling short of an employee's rights under the ESA run the risk of incurring liability for pay in lieu of reasonable notice under the common law. The notice periods being awarded by the courts, particularly for short service and more junior level employees, have become increasingly generous and expensive.

Clauses that are drafted in reference only to "notice" or "pay in lieu of notice", without provision for continuation of benefits or severance pay entitlements under the ESA are at risk. Clauses that

then go on to state that the employee will not be entitled to anything further will also be at risk of not being enforced.

Employers also need to ensure that the employee is receiving something in return as "consideration" for the employee's agreement to the clause. An offer of employment to a new employee will usually be sufficient consideration, but employers should be careful that the termination clause is not presented after employment commences or after the job offer is accepted by the employee. Signing bonuses or promotions can also be valid consideration for an employee agreeing to a termination clause.

Termination clauses should be prepared or reviewed by a lawyer who specializes in employment law. The caselaw has created too many traps for a "DIY" approach or relying on the advice of consultants or even lawyers who are not specialized in employment law.

Termination clauses should also be reviewed periodically by an employment lawyer to ensure that they are still enforceable as the caselaw in this area will likely continue to develop.

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