Ontario's Court of Appeal Strikes Down Yet Another Termination Clause

By Landon Young and Frank Portman

Recent decisions from the Ontario courts have not been kind to employers seeking to limit employees' termination entitlements through written agreements.

Last March, the Ontario Court of Appeal confirmed that where a termination clause provides less than any one of the minimum entitlements on termination called for in the **Employment Standards Act, 2000** ("ESA"), it is unenforceable. The result will be that the employee is entitled to pay in lieu of reasonable notice under the common law, which are typically much more generous than those provided for by the ESA (see our update on that decision here).

The Termination Clause Excluded Commissions

A recent Court of Appeal decision confirmed that this is true even when there is a clause in the agreement that states any potentially illegal clauses can be struck out while leaving the result of the agreement intact (commonly known as "severability" clauses).

In North v Metaswitch Networks Corporation, the question before the judge at first instance was simply whether a termination clause was enforceable. The termination clause read as follows:

> **9. Termination of Employment**
>
> (c) Without Cause – The Company may terminate your employment at any time in its sole discretion for any reason, without cause, upon by [sic] providing you with notice and severance, if applicable, in accordance with the provisions of the Ontario Employment Standards Act (the "Act"). In addition, the Company will continue to pay its share all [sic] of your employee benefits, if any, and only for that period required by the Act.
>
> The reference to notice in paragraphs 9(b) and (c) can, at the Company's option, be satisfied by our provision to you of pay in lieu of such notice. The decision to provide actual notice or pay in lieu, or any combination thereof, shall be in the sole discretion of the Company. All pay in lieu of notice will be subject to all required tax withholdings and statutory deductions.
>
> In the event of the termination of your employment, any payments owing to you shall be based on your Base Salary, as defined in the Agreement.

While this clause may, at first blush, appear to be compliant with the ESA, the employee was entitled to more than just base salary as part of his employment compensation – specifically he was also entitled to have commissions included in the calculation.

Where an employee is paid on a basis other than time, such as by commission, the calculation of pay in lieu of notice must be based on the average total pay during the 12 weeks preceding termination. The exclusion of commissions in the third paragraph cited above meant that the employee's entitlements would be less than that required by the ESA.

The Severability Clause Did Not Save the Termination Clause

However, this was not the end of the story. The contract also had a severability clause. This clause provided that if any part of the employment agreement was found to be illegal or otherwise unenforceable by a court, that part would be severed from the agreement and the rest of the agreement's provisions would remain in full force and effect.

The employer argued that the severability clause served to automatically revise the contract by expunging the language restricting entitlements to base salary. Once the third paragraph of the clause was severed, the employer argued, the remaining termination clause was valid and limited the employee's entitlements to ESA minimums.

The judge at first instance agreed and dismissed the employee's claim for reasonable notice.

The Court of Appeal reversed that decision and determined that the severability clause could not be used to save the termination provision.

The approach to be used, according to the Court of Appeal, is straightforward, and resulted in the termination clause in this case being declared unenforceable.

The termination clause as a whole must be evaluated to see whether it provides an entitlement equal or greater to that set out in the ESA. If the entitlement falls below that amount, then the clause is void as a whole despite any other terms elsewhere in the contract. In other words, the termination clause is a single, unitary clause that succeeds or fails as a single entity and cannot be subdivided.

There was, therefore, nothing to sever from the termination clause. It was simply unenforceable.

On this case, this meant that once the termination clause was found to violate the ESA, no further analysis was required, and the clause was inoperative.

Moreover, it meant that because the clause was struck in its entirety, the employee was entitled to full common law notice.

The Takeaway: Less Can be More When Drafting Termination Clauses

The decision of the court in **North** underscores the risks of using complex termination clauses. The extra clause limiting the employee's termination pay to base pay is what created the problem.

A simple and relatively short clause that states an employee's entitlements upon termination will be limited to the requirements of the ESA will usually be sufficient. Employers sometimes create

problems when the clause contains more complex language that tries to overreach when it comes to limiting the employer's liability upon termination.

Agreements with employees who have atypical or more complex compensation structures, including stock options, commissions or special bonuses, may require additional or more complex language. However, such language should be very carefully considered and only implemented after legal advice is received.

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