Law Society of Ontario | Barreau de l'Ontario

TAB 13

The Six-Minute Debtor-Creditor and Insolvency Lawyer 2022

The Unenforceable Employment Contract: What's Left of Employment Contract Termination Clauses

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October 13, 2022

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All too often, lawyers find themselves called upon to advise on workplace terminations. Whether we are asked to assist with an employer's layoffs, terminations or shutdowns, or to answer an employee's questions about their rights in the face of an actual or anticipated job loss, the logical first step is going to involve ascertaining the terms and conditions of each individual employee's contract of employment[1], whether such a contract has been put into writing or not.

The exercise is not, however, a simple one of interpreting and applying contractual provisions and following them, or expecting them to be followed. While it has always been the case that employees who have no written contract are entitled to reasonable notice of termination, written contracts only entitle the employee to reasonable notice if they lack an **enforceable** termination provision that provides for less than that – most frequently the far more modest statutory minimums contained in the Ontario Employment Standards Act, 2000[2] (the "*ESA*").

Subsection 5(1) of the *ESA* prohibits the contracting out of or waiver of an employment standards, and provides that "any such contracting out or waiver is void". The full scope of such voiding of contractual terms has, as a result of a number of Ontario Court of Appeal cases over the past 5 years, come to be understood to reach far more broadly than prior common wisdom might have suggested.

In order to understand and quantify the liabilities arising out of such employment contracts, one must be able to identify those that have unenforceable limitations on termination entitlements lurking within. To do so, a five year line of decisions of the Ontario Court of Appeal, culminating in *Waksdale v. Swegon North America Inc*[3]*.,* and *Rahman v. Cannon Design Architecture Inc.*[4], must be considered.

I attempt herein to provide some tools that would be of assistance in any such effort.

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[1] This paper deals only with the situations faced with non-unionized employees. Where there is a unionized workforce, the essentials of layoffs and terminations are entirely different than in the context of the individual contract of employment which will apply to non-union / management employees only. The non-unionized employees in such a setting do, however, continue to be governed by individual contracts.

[2] SO 2000, c41

[3] *Waksdale v. Swegon North America Inc.,* 2020 ONCA 391 (CanLII), https://canlii.ca/t/j89s5

[4] *Rahman v. Cannon Design Architecture Inc.*, 2022 ONCA 451 (CanLII), https://canlii.ca/t/jpnjp

First Principles:

- At common law, a term is implied into all unwritten contracts of employment, as well as those written contracts[5] that do not address the question of employee entitlements upon termination. This implied term requires that an employee who is terminated from their employment in the absence of "Just Cause" is entitled to **reasonable notice** of that termination, or to pay in lieu of such notice.

- Such reasonable notice is determined on the longstanding *Bardal*[6] factors of "the character of the employment, the length of service of the servant, the age of the servant and the availability of similar employment, having regard to the experience, training and qualifications of the servant"[7]. While some situations warrant the provision of only a few weeks of reasonable notice, the vast majority of employees will be entitled to a number of months of notice, which in some cases can exceed 24.

- Also at common law, it is open to an employer to terminate the employment relationship with Just Cause, in which case no notice or money would be owing to the employee over and above amounts earned up to the termination date. Such cause can take many forms, from outright insubordination or theft of employer property to an inability to perform the essential duties of the job, despite ample warnings and supportive measures.

- Overlaid upon this, however, is the *ESA*, which sets a broad range[8] of minimum terms of employment for most employees,[9] including **both** a minimum notice period (satisfied through actual "working notice" or "termination pay" – i.e. pay in lieu of notice, or a combination thereof) ranging from 1 – 8 weeks **and** "severance pay" of as much as 26 weeks' wages[10], payable as a lump sum upon termination of the employment relationship unless instalments are agreed to by both parties. Severance pay, however, is only payable in limited circumstances, most commonly where the duration of employment has met or exceeded 5 years and the employer has a payroll

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[5] Other than those that provide for a fixed term of employment.

[6] *Bardal v. Globe & Mail Ltd.,* 1960 CanLII 294 (ON SC), <https://canlii.ca/t/gghxf>, [1960] OJ No 149 (QL), [1960] CarswellOnt 144, 24 DLR (2d) 140

[7] *Ibid* at p. 145 DLR

[8] Including minimum wage, rights to overtime pay, parental leaves and public holidays in addition to the termination rights discussed here.

[9] A number of employment contexts are excluded by regulation. In the case of employment termination, this includes construction employees, those whose contracts of employment have become frustrated or impossible of performance, and most notably, employees who have "been guilty of wilful misconduct, disobedience or wilful neglect of duty that is not trivial and has not been condoned by the employer". These exclusions apply to entitlements both to statutory notice and to severance pay.

[10] "Wages" a defined term in the *ESA* extend beyond hourly pay or salaries, to include all contractual forms of remuneration such as bonuses and commissions, to name but a few.

of $2.5 million or more.[11] Severance pay is also payable where there is a permanent discontinuance of all or part of the employer's business at an establishment, and the employee is one of 50 or more employees who have their employment relationship severed within a six-month period as a result.

- In addition to notice and severance pay, s. 60(1)(c) of the *ESA* also provides that during the statutory notice period of 1 – 8 weeks, as the case may be, the employer is required to continue to pay for benefit plan contributions in order to maintain the employee's benefits under the plan until the end of the notice period.

Machtinger v. HOJ Industries Ltd.[12]

The seminal case in the history of termination clauses in employment contracts being invalidated by the courts is the 1992 decision of the Supreme Court of Canada in *Machtinger v. HOJ Industries.*

The written contract of employment there at issue contained the following termination provision:

> "Termination -- Employer may terminate employment at any time without notice for cause. Otherwise, Employer may terminate employment on giving Employee __0__ [13] weeks notice or salary (which does not include bonus) in lieu of notice. Bonus, if any, will be calculated and payable only to the date of the giving of notice of termination."

Upon termination, both appellant employees were in fact paid the equivalent of four weeks' salary, amounts in excess of their *ESA* entitlements, but well below what would be payable if common law notice were to be awarded.

Justice Iaccobucci, writing for the court, referred to section 3 of the then-current *ESA*, which provided that "no employer, employee, employers' organization or employees' organization shall contract out of or waive an employment standard, and any such contracting out or waiver is null and void"[14]. He found that the contracts of employment attempted to contract out of the minimum standards of the *ESA* by specifying notice periods shorter than the statutory

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[11] *ESA,* s. 64.

[12] *Machtinger v. HOJ Industries Ltd*., 1992 CanLII 102 (SCC), [1992] 1 SCR 986, <https://canlii.ca/t/1fsd2>

[13] It was a fill-in-the-blanks standard form contract. In the case of Machtinger, notice was written in as zero, while a co-appellant had contracted for 2 weeks' notice.

[14] Now section 5, the corresponding language now reading, "no employer or agent of an employer and no employee or agent of an employee shall contract out of or waive an employment standard and any such contracting out or waiver is void."

minimum[15], and hence, the portion of the contract specifying the notice period was held to be null and void.

It had been argued by the employer that the termination language of the contracts nonetheless clearly expressed the intention of the parties that the employees were only entitled to the absolute minimum legal amount of notice. Pivotally, the Court rejected this argument, concluding that "if a term is null and void, then it is null and void for all purposes, and cannot be used as evidence of the parties' intention. If the intention of the parties is to make an unlawful contract, no lawful contractual term can be derived from their intention."[16]

The upshot of this was that while employers and employees were entirely free to enter into contracts that provided for the provision only of the minimum notice period, if they deviated from that, with a contractual termination clause that ran contrary to the *ESA,* then common law reasonable notice would apply in the event of a "Without Cause" dismissal.

This, then, was the status quo as seen by most employment lawyers after *Machtinger.* In drafting our employment contracts, it was essential to ensure that they provided for a **minimum** notice period (or payment in lieu) that equalled or exceeded the termination entitlements under the *ESA*.

I don't think that too many employment lawyers during this time were concerned about also continuing benefits in our termination clauses, as required under *ESA* s. 60(1)(c).

***Wood v. Fred Deeley Imports Ltd.*[17]**

But benefits were brought to the fore by the Ontario Court of Appeal in 2017, in *Wood v. Fred Deeley Imports Ltd.* This was a case of what might previously have been seen as a compliant termination clause:[18]

> "[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*." (emphasis added)

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[15] Although the quantum of entitlement has changed under the current *ESA*, the applicable principles remain in place.

[16] At p. 1001, S.C.R.

[17] *Wood v. Fred Deeley Imports Ltd.,* 2017 ONCA 158 (CanLII), https://canlii.ca/t/gxn69

[18] Although at least two earlier Superior Court decisions, *Wright v. The Young and Rubicam Group of Companies (Wunderman)*, 2011 ONSC 4720 (CanLII), https://canlii.ca/t/fnr50 and *Stevens v. Sifton Properties Ltd.*, 2012 ONSC 5508 (CanLII), https://canlii.ca/t/fvkn5 suggested otherwise.

To be clear, there is no point in time where two weeks' notice per year of employment would provide less than the sum of the minimum notice pay and severance pay under the *ESA*.

But benefits…

The language of the termination clause, providing that the enumerated payments the employer "agreed to make are the *only payments* Wood is entitled to; they are "inclusive" of her entitlements under the *ESA"*[19]. This "all inclusive" language effectively excluded the provision of the s. 60(1)(c) benefit continuation, and was, accordingly, contrary to the *ESA.* As a result, the termination clause was found to be void and unenforceable, **despite the fact that during the 13 weeks of working notice that had, in fact been provided, the employer not only paid the employee's salary, but also paid for benefits.** Common law notice of 9 months was therefore awarded.

A key takeaway, then, is that compliance with the *ESA* at the time of and following termination cannot revive a contract provision that was *void ab initio* for non-compliance with the *ESA*[20].

North v. Metaswitch Networks Corporation[21]

Although not a part of the usual narrative, *North v. Metaswitch Networks* was decided closely after *Wood,* and provides a useful aside. In this case a three-paragraph termination section was found to be deficient based solely on the language of the third such paragraph, which based all termination payments on base salary alone, to the exclusion of commissions that were required[22] under the *ESA* to be included in that calculation:

> "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."

[19] *Wood,* at para 56

[20] Similarly, see *Rossman v. Canadian Solar Inc*., 2019 ONCA 992 (CanLII), https://canlii.ca/t/j45fl, where the contract provided for a fixed period benefit continuation of 4 weeks. The employee was terminated after 3 years and nine months of employment. He was therefore entitled under the *ESA* to a benefit continuation of 3 weeks. But the contract had to be read in the context of the circumstances as they existed at the time it was created, when the duration of employment could readily be anticipated to exceed 5 years. Hence, the provision was void.

[21] *North v. Metaswitch Networks Corporation*, 2017 ONCA 790 (CanLII), https://canlii.ca/t/h6mfv

[22] See the earlier point about the statutory definition of "wages".

The employer argued that a severability clause[23] saved the balance of the termination paragraph, a position that was disposed of by the Court of Appeal as follows:

> "…where a termination clause contracts out of one employment standard, the court is to find the entire termination clause to be void, in accordance with s. 5(1) of the *ESA*. It is an error in law to merely void the offending portion and leave the rest of the termination clause to be enforced[24].

The rule, then, that severability clauses will not save an illegal termination provision, is clear, but one should particularly note the words, "find the entire termination clause to be void", foreshadowing what was to come in *Waksdale*, discussed below.

Nemeth v. Hatch Ltd.[25]

Wood and *North* were followed closely by the Court of Appeal's 2018 decision in *Nemeth v. Hatch*. It provided a breath of fresh air to employers (and their counsel) in that it upheld a contractual provision that limited the employee's entitlement on termination as follows[26]:

> "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."

The plaintiff had argued that this termination clause was void because it purported to contract out of the appellant's statutory entitlement to severance pay by the absence of any reference to this entitlement[27]. But following and expanding upon the court's earlier decision in *Roden v. Toronto Humane Society*[28], Justice Roberts held that silence could not constitute an attempt to contract out of an employment standard; the termination clause addressed **only** the notice period. It contained no limiting wording as in *Wood* with respect to severance pay (or benefit continuation), and at no time could the application of the contractual wording be applied to result in an entitlement to notice that would be less than the notice entitlement under the *ESA*.

Enter *Waksdale*.

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[23] "If any part of the Agreement is found to be illegal or otherwise unenforceable by any court of competent jurisdiction, that part shall be severed from this Agreement and the rest of the Agreement's provisions shall remain in full force and effect."

[24] *North,* para 24

[25] *Nemeth v. Hatch Ltd.*, 2018 ONCA 7 (CanLII), https://canlii.ca/t/hpp9n

[26] *Nemeth* at para 3

[27] One might note that it made no reference to benefits, either, but this point does not appear to have been argued.

[28] *Roden v. Toronto Humane Society*, 2005 CanLII 33578 (ON CA), https://canlii.ca/t/1lmtb

***Waksdale v. Swegon North America Inc.*[29]**

The Court of Appeal's decision in *Waksdale v. Swegon* is unusual in this category of cases, in that it does not provide the reader with the actual contractual language at issue. Nonetheless, the termination provisions were found to be unenforceable because they violated the *ESA*.

As do many employment contracts, this one had a provision that applied in the event of termination Without Cause (and which, up to this point was the primary focus of the contractual analysis) and another that applied in the event of termination for Just Cause. Counterintuitively, perhaps, employer counsel conceded that the termination for Just Cause provision in the employment contract breached the *ESA*; but how, we'll never know.

But the Without Cause provision was considered to be entirely unobjectionable. Again, the language was not reproduced, but plainly, it effectively limited entitlement on termination to the minimum requirements of the *ESA*. The employee having been terminated Without Cause, the question addressed by the Court was whether the illegality of the Just Cause provision rendered the Without Cause provision unenforceable. The central issue then, was whether the two clauses should be considered separately, or whether the faulty termination for Just Cause provision extended to invalidate the Without Cause provision and replace it with common law entitlement.

The Court of Appeal found that in light of the power imbalance between employers and employees, coupled with the protections of the *ESA*, the focus should be on whether, looking at the full scope of all termination provisions in the employment contract, the employer has violated the employee's *ESA* rights. If it has done so, then regardless of whether the termination provisions are contiguous or separated within the contract, they stand or fall as a whole. Harkening back to *Wood,* it did not matter that the employer had relied only upon the (otherwise sound) Without Cause provision; the contract's full set of termination provisions were unenforceable from inception.

Looking back to *North*, where the entire Without Cause clause was found to be void, it followed that this approach, of looking at all of the termination provisions together as an integral whole, meant that a severability clause could not operate to rescue only the Without Cause provision. The termination provisions had to be read together as a whole and stand or fall accordingly.

Importantly, *Waksdale* did not explain what was wrong with the Just Cause provision. Given that all aspects of the *ESA* were respected in the Without Cause provision, what offending language could possibly be contained in any Just Cause provision given the common law principle that employees terminated with Just Cause are entitled to nothing beyond the wages that they have earned? The answer came soon enough.

[29] *Waksdale v. Swegon North America Inc.,* 2020 ONCA 391 (CanLII), https://canlii.ca/t/j89s5

Rahman v. Cannon Design Architecture Inc[30]

In *Rahman*, the operative language appeared in the offer letter executed by both employer and employee at the outset of the employment. It read:

> "CannonDesign maintains the right to terminate your employment at any time and without notice or payment in lieu thereof, if you engage in conduct that constitutes just cause for summary dismissal."

An interesting feature of the *ESA* is that it contains no language at all relating to Just Cause. Indeed, sections 55 and 64 of the *ESA* simply say that "prescribed employees" are not entitled to notice or severance pay under the legislation. The standard for the nature of conduct that disentitled an employee was left to a regulation.

The Termination and Severance of Employment Regulation disqualifies from the receipt of notice or severance pay "An employee who has been guilty of wilful misconduct, disobedience or wilful neglect of duty that is not trivial and has not been condoned by the employer."

This wilful misconduct standard has been said by the court to require evidence that the employee was "being bad on purpose". More comprehensively, one might say that each of the three disqualifying factors of "wilful misconduct, disobedience or wilful neglect of duty" share a unifying theme of voluntariness. In contrast, it has been held over the years that circumstances such as persistent carelessness or incompetence may nevertheless constitute Just Cause.

In short, where the contract contains a Just Cause provision that disentitles the employee from the receipt of notice or pay in lieu of notice, it allows for circumstances where an employee who was NOT "guilty of wilful misconduct, disobedience or wilful neglect of duty" might nonetheless be dismissed for Just Cause without notice.

While some contracts might very well reference Just Cause and remain valid, they would have to unequivocally provide that first and foremost, the employee will receive everything to which they are entitled under the *ESA*, provided that they have such entitlement.

This only makes sense where the contract provides for something more than the *ESA* minimum for employees terminated through no fault or flaw of their own, such as downsizing, acquisition of the employer, or insolvency. Given that the usual goal of such contracts is to provide a universal limitation on notice and severance payments, there has in the past been little reason to draft a contract in such a manner except where an employee at hiring has negotiated an improvement to a proposed *ESA* minimum provision. It is of course possible, if not likely, that such contracts might very well become far more common in the years to come, my own approach to drafting having evolved to first declaring that the *ESA* will always be complied with, and then adding in any Without Cause entitlements that may be required.

[30] *Rahman v. Cannon Design Architecture Inc.*, 2022 ONCA 451 (CanLII), https://canlii.ca/t/jpnjp

Conclusion

Where a decision is to be made to terminate the employment of some or all of an employer's employees due to a need to downsize, whether that need arises from external circumstances or an insolvency situation, it is important to know what the termination is going to cost. Where there is no written contract of employment (or signed employment offer letter, which amounts to the same thing), the situation stands as it always has, with an assessment of what constitutes common law reasonable notice in accordance with the *Bardal* factors as currently applied by the courts.

But a signed contract with notice provisions, which in the past might have provided a significant degree of certainty as to the liability at hand, may very well be the equivalent of no contract at all, when it comes to termination of employment. While a contract that provides for notice less than that mandated by the *ESA* has, since *Machtinger*, been entirely ineffective at ousting the presumption of reasonable notice, the Court of Appeal has made it abundantly clear that employers (and their contracts) are to be held to a higher standard than merely that: there can be no reliance upon the stated notice period and payments if any reasonable reading of that contract would relieve the employer of its statutory obligations under any possible termination scenario.

In short, before relying upon the written termination provisions of an employment contract, one must look for any potential flaws. To date, they include:

- A stated notice period that, regardless of the duration of employment, could possibly produce an entitlement less then that provided for under the *ESA* (*Machtinger)*;

- A termination provision that limits what a worker is to receive in such a way as to as to permit a denial of any termination entitlement, whether or not such entitlement is in fact withheld (*Wood, Rossman);*

- A limitation such that payments are to be calculated on something less than the employee's regular earnings, such as base salary only, to the exclusion of the value of commissions that were being earned up to the date of termination (*North*);

- A severability clause that purports in the face of possibly illegal provisions to save the portions of the termination language that are not illegal (*North)*;

- Flawed language as it relates to termination entitlements, **anywhere in the contract** (*Waksdale);*

- A standard that would permit termination of employment without liability, where that standard would deny such entitlement to someone who is not guilty of "wilful misconduct, disobedience or wilful neglect of duty".

Finally, a parting note. The “wilful misconduct, disobedience or wilful neglect of duty” language is not embedded in the statute, but as mentioned above, is contained in a regulation that can be amended at any time, not by the Legislature in a public vote, but by the Ontario cabinet, behind closed doors. Should this happen, the employment bar might just be left scratching its collective head, wondering about what THAT just did to the validity of thousands of employment contracts. We may certainly have drafted carefully in the past, but this prospect, and the trendline of the past five years’ jurisprudence coming out of the Court of Appeal, is forcing that level of care up to a whole new level: clairvoyance.