8 Effective Use of Employment Agreements

One of the first things that we ask when we retain a new employer client is whether or not it utilizes an employment contract. If it does, our first order of business is a thorough review of the employment contract. Not only does an employment agreement set out the agreed-to terms and conditions of the subject employment relationship, but it also is the most effective way to address and limit an employer's liability in the event that it wishes to terminate one of its employees. However, in order for the employer to do so, the employee must have received consideration for agreeing to its terms. Without an employment agreement, our courts will infer that the employment relationship is governed by provincial employment legislation and the common law. In the event of a termination without an employment contract, our courts will deem an employee to be entitled to reasonable notice to termination under the common law. The difference in potential exposure to an employer with an enforceable agreement and an employer without an enforceable agreement is significant. By way of example, the common law may entitle a 60-year-old managerial employee who has been employed for 22 years to 24 months of notice under the common law. An enforceable employment agreement could successfully and legally limit that same employee to only eight weeks of notice.

We do not always recommend that our employer clients limit their liability to the absolute legal minimum—that is, in order to make a competitive offer to an attractive candidate, we often suggest agreeing to a more generous formula—but we will always, without exception, recommend that our clients include a provision that minimizes cost to the company, provides certainty to both parties, and is legally enforceable.

I. Ensuring Enforceability

Unfortunately, what makes an employment agreement enforceable is relatively fluid. There is no hard and fast blueprint on which an employment agreement can be based, because the law surrounding employment relationships is always evolving. Consequently, employment agreements require consistent review and updates in order to remain in line with the jurisprudence of the day.

The first stage at which an employer—and an employee—will require legal advice is when the employment contract is first being formed. Perhaps above all else, it is important that the employment contract be clear and unequivocal in its language.[1] An employee must know what she is signing. To the extent that there are any ambiguities in a contract of employment, the legal principle of *contra proferentem* will operate so as to construe them in favour of the employee and against the employer.[2] By way of

1 *Re Fallon*, 1998 CarswellOnt 7675 (Ontario Employment Standards Branch); *Casino Rama Services Inc v Paul*, 2007 CanLII 910 (OLRB).

2 *Hunte v Ontario (Superintendent of Financial Services)*, 2014 ONSC 1270 (Div Ct); *Dan Lawrie Insurance Brokers Ltd v White*, 2012 ONSC 1115; *Landry v 1292024 Ontario Inc*, 2006 CanLII 15142 (Ont Sup Ct J).

example, if a termination provision is worded so as to afford a number of possible interpretations, it will be construed in such a way as to most benefit the employee.

So the first rule in drafting a contract for an employment relationship is to use clear, simple wording that can easily be understood by the intended audience. An employer will gain no points by obfuscating the language so as to make it incomprehensible and may, in fact, stand to have it harm its interests.

II. Consideration

An employee must also receive valid consideration in exchange for his agreement to the proposed terms of an employment contract. Essentially, an employee must get something in return—and that "something" can indeed be many things, as long as it is of some benefit to the employee. A classic example that lawyers frequently use to illustrate just how wide the ambit of consideration can be is that of a peppercorn—if an employer offers a peppercorn in exchange for the execution of an employment agreement, and the employee accepts the peppercorn as consideration for same, the peppercorn will constitute valid consideration.

At the very beginning of the employment relationship—when the employee is first hired—the provision of wages and benefits (i.e., a job) will constitute the consideration. Thus, it is always recommended that employment contracts be entered into *prior to* the employee commencing employment so that it may be clear that the job was provided to the employee *in exchange for* his agreement to the employment contract.

After an employee has commenced employment, if an employment contract is imposed, or an addition or amendment that is not mutually agreed to is made to the terms of the employment contract, it will require additional consideration. That is, merely allowing the employee to keep his job in exchange for executing a new or revised agreement will not constitute consideration at law.[3] In order to introduce a contract after the commencement of the employment relationship, the employee must receive something new in exchange for his agreement to the contract. This is why we typically recommend offering a new contract—or making changes to the existing contract—alongside giving a raise or a bonus, introducing new benefits, etc. Of course, every situation will be different and warrant its own analysis, but so long as the new consideration cannot be construed as something to which the employee was already entitled, the employer can likely rely upon same as the basis for introducing a new employment agreement or contractual term.

Particular care must be taken with the late imposition of termination provisions. If the employment relationship commences without an employment contract (and, therefore, without a termination provision), our courts will imply a term of reasonable notice under the common law into the employment relationship. The Ontario Court

3 *Braiden v La-Z-Boy Canada Ltd*, 2008 ONCA 464, 294 DLR (4th) 172; *Hobbs v TDI Canada Ltd*, 2004 CanLII 44783, 246 DLR (4th) 43 (Ont CA).

of Appeal noted that an employer that subsequently tries to introduce an express term contradicting an implied term of reasonable notice is attempting to introduce a "tremendously significant modification" to an existing contract, and will require clear consideration.[4] That being the case, we tend to recommend that termination provisions be introduced only at the start of the employment relationship or upon providing unequivocal consideration to the employee. The practical effect of this is that an employer will often pay to include a termination provision in a contract of employment if it is not clearly outlined in one prior to the employee commencing work.

In this regard, timing is extremely important. If an employer means to introduce an employment contract at the point of hiring but does not get around to sending it to the employee until her first week of work—or, more commonly, waits until the employee's first day and then provides her all of the onboarding paperwork, of which the contract is a part—then *the contract will not be enforceable*. This is because the job has already been started, and it is already something that the employee has, so it cannot be "given" again in exchange for signing an employment agreement. The same is true for introducing changes to a contract when providing a raise or paying a bonus. If the raise or bonus or promotion is provided before the employee's agreement to the terms, then it may not be construed as valid consideration.

So the second rule in drafting a contract in the context of an employment relationship is to provide the employee with a clear benefit for agreeing to the contract, either at the outset of the employment relationship, at which time the job may be granted to the employee in exchange for his agreement to the terms of the contract, or subsequent to the commencement of the relationship upon the provision of additional consideration.

III. Compliance with Employment Standards Legislation

In addition to the provision of consideration, and the clear and unambiguous way in which a termination provision must be drafted, there are myriad principles and rules governing termination provisions that all conspire to render a termination provision unenforceable. Generally speaking, however, we consider the third rule in drafting a contract in the context of an employment relationship to be ensuring that the contract conforms to the minimum standards of provincial employment legislation.

This rule is at its most relevant when it comes to contractual termination provisions, which will be considered of no force or effect if they breach provincial employment legislation. For example, where an employment contract purports to allow the employer to terminate an employee with no notice whatsoever, and without cause, that provision will be rendered unenforceable.[5]

4 *Francis v Canadian Imperial Bank of Commerce* (1994), 21 OR (3d) 75 (CA).

5 *Machtinger v HOJ Industries Ltd*, [1992] 1 SCR 986.

Another, much more subtle, example is when a termination provision does not explicitly provide for one of the other entitlements upon termination (beyond notice of termination) guaranteed by provincial employment standards legislation. To illustrate, when a termination provision does not explicitly state that an employee will receive severance pay if she qualifies for same, it may be deemed unenforceable. In Ontario, where a termination provision does not make it clear that said severance pay will be paid to the employee rather than provided to the employee by way of working notice, it may be found to be of no force or effect.

Another recent example that is garnering considerable attention is termination provisions that fail to explicitly state that benefits will be continued for the duration of the statutory notice period. Given that most provincial employment standards legislation guarantees the continuation of benefits for the statutory notice period, some courts have been finding that a failure to explicitly provide for this in the termination provision renders the provision void.[6] That is, there is some question and debate about termination provisions that do not explicitly state that an employee will continue to have access to his benefits at the same time as, and in addition to, his statutory period of notice.

Many of the issues that have confounded and angered both employers and employee regarding termination clauses were finally heard by the Ontario Court of Appeal in *Wood v Fred Deeley Imports Ltd*.[7] Prior to *Wood*, the decisions of the courts were erratic and contradictory. Similar termination clauses would be struck down by one court and upheld by another. The Court of Appeal in *Wood* made a number of conclusive findings, putting to rest several contested arguments.

First, the court was asked to determine whether a termination clause that failed to provide explicitly for group benefits was in violation of the *Employment Standards Act, 2000*. Second, the court was asked whether the failure to explicitly mention severance pay also constituted a violation of the Act, even in a situation where the terminated plaintiff would not have qualified for severance pay. After reviewing the conflicting case law, the court ultimately found that, in both instances, the failures resulted in a violation of the Act and entitled the plaintiff to common law notice and damages. The court found that, while in both instances the termination clause could be reasonably interpreted in more than one way, such ambiguity would be held against the party that had drafted the termination clause and in favour of the party that had not (i.e., the aforementioned principle of *contra proferentem* would apply). This decision, while certainly a shock to many employers whose employment contracts may now no longer be valid and enforceable, has finally brought some much-needed clarity to the law.

6 *Stevens v Sifton Properties Ltd*, 2012 ONSC 5508.

7 2017 ONCA 158.

IV. Limiting Liability

Although we hesitate to even suggest that there exists some contractual equivalent of a panacea for the countless ways in which a termination provision may run afoul of employment standards legislation, many employers use what are colloquially referred to as "savings clauses" to great effect. These provisions are typically included as part of a termination provision, but can also be found at the beginning or end of a contract of employment with no real difference in impact. A savings clause simply guarantees that the employee will always receive his minimum entitlements under employment standards legislation, and that if there should be a discrepancy between the terms of the contract and the terms of the legislation, the legislation will always prevail. The practical impact of this is that, even where a termination provision may technically falter, a savings clause can be used to argue that the contract still guarantees that the employee will receive his minimum entitlements and is, therefore, enforceable.

While a savings clause can be quite an effective defence against a claim that the contract (or a contractual provision) is unenforceable because it contravenes employment standards legislation, it obviously cannot assist an employer in every scenario. For example, where an employer breaches the terms of its own contract, there is some case law that suggests that the employer is thereafter prevented from relying upon its provisions in order to deprive the employee of some greater right or benefit. Similarly, if an employer makes the provision of an employee's statutory minimum entitlements subject to a condition precedent—for example, if the employee will not be paid her minimum entitlements until she has executed a release—the termination provision may be found to be null and void.[8] The courts can even order that the employer pay further damages for "bad faith dismissals," regardless of the existence of a savings provision or ironclad termination clause.[9]

Unfortunately, even a clear and enforceable termination provision cannot completely mitigate against employer liability. For example, an employer must ensure that any employment contract reserves the employer's right to make reasonable changes to the terms or parameters of the employee's position without constituting a constructive dismissal. Otherwise, an employer's decision to relocate an employee, remove or change parts of a benefits plan, or to make any other seemingly innocuous change to the terms of an employee's employment could allow the employee to treat the employment relationship as having been constructively terminated.

An employment contract must also include language that ensures the survival of the terms of the contract throughout any changes to an employee's position or title, in order to avoid what is known as the "substratum" argument.[10] That is, there is

8 *Stolle v Daishinpan (Canada) Inc*, 1998 CanLII 2473, 37 CCEL (2d) 18 (BCSC).

9 *Chabot v William Roper Hull Child and Family Services*, 2003 ABQB 49.

10 *MacGregor v National Home Services*, 2012 ONSC 2042; *Rasanen v Lisle-Metrix Ltd*, 2002 CanLII 49611, 17 CCEL (3d) 134 (Ont Sup Ct J).

jurisprudential support for the proposition that the terms of an employment contract will not automatically transfer to an employee's new position if the new position is significantly different from the position she held at the time that the terms were agreed to.[11]

For a full discussion of the myriad ways that employment agreements in general and termination clauses in particular may become unenforceable, we recommend the excellent book written by David Harris and Kenneth Alexander: *The Written Contract of Employment*.[12]

V. Independent Contractors Versus Employees

Generally speaking, enforceable agreements to limit an employee's entitlements to the minimum standards set out in provincial employment legislation will be upheld. However, one area where the parties' respective intentions and characterizations will be of little consequence to the court is with respect to the nature of the employment relationship and, specifically, the distinction between an employee and an independent contractor.

Broadly speaking, an independent contractor is an individual who provides services for a company without being an employee of same. Independent contractors ultimately work for themselves. Thus, many of them are self-incorporated, but this is far from being a definitive confirmation that the individual will not be legally considered to be an employee. In fact, whether an individual will be legally characterized as an employee or an independent contractor is entirely dependent on the factual nexus of the working relationship as a whole and has very little to do with what an individual calls himself or what the company wishes to characterize him as. Even the case law is fairly broad and unhelpful in this regard, pointing employment counsel in the direction of considerations of vague notions like "control" and "integration." It is generally considered to be the case that where an individual is "integrated" within the company and exercises very little "control" over his work, that individual is considered to be an employee. Ultimately, this is still far too simplistic an analysis, given the multitude of factors that ultimately must be considered in assessing whether or not someone is an employee, including the following:

- chance for profit/risk of loss;
- the provision of a company uniform/business cards/office space/office supplies;
- the provision of tools to complete the services contracted for;

11 *Sawko v Fosesco Canada Ltd* (1987), 15 CCEL 309 (Ont Dist Ct); *Irrcher v MI Developments Inc*, 2002 CarswellOnt 5590 (Sup Ct J); *Dolden v Clarke Simpkins Ltd* (1983), 3 CCEL 153 (BCSC).

12 (Toronto: Emond Publishing, 2016).

- whether the worker exercises any discretion over his schedule/salary or hourly wage/list of clients; and/or
- whether benefits are provided and/or paid for by the company.

The practical effect of this characterization—that is, whether one is an employee or an independent contractor—can be quite significant, given that independent contractors are not entitled to reasonable notice of termination outside the parameters of what a contract may provide. That is, unless a contract provides otherwise, an independent contractor may be terminated with immediate effect and without notice.

Canadian courts have also recently recognized a third category of worker, sitting somewhere in the grey area between "employee" and "independent contractor," known as a "dependent contractor." Dependent contractors typically exercise a significant amount of control over their work and are in business for themselves, but perform the vast majority of their services for one company, making them financially dependent on the relationship. This financial dependency seems to be the key difference between independent contractors and dependent contractors. Our courts have found that dependent contractors are, in fact, entitled to reasonable notice of the termination of their employment, much in the same way that employees are.[13]

However, a dependent contractor subject to a contract that provides for the length of notice that she will receive upon termination will typically be held to the contractual provisions to which she agreed. This is also true in situations where a dependent contractor is subject to a fixed-term contract without an exit clause, which would typically entitle the contractor to be made whole for the duration of the contract's term, without the concomitant duty to mitigate.

For a sample employment agreement with a termination clause, see Appendix 8.1, below.

13 *Pennock v United Farmers of Alberta Co-Operative Ltd*, 2006 ABQB 716; *Sarnelli v Effort Trust Co*, 2011 ONSC 1080; *Keenan v Canac Kitchens Ltd*, 2015 ONSC 1055.

Appendix 8.1 Sample Employment Agreement

Employment Agreement
September 7, 2018

Ms. Judy Doe

999 Main Street
Anytown, Ontario
A1A 2B8

Dear Judy,

We are pleased to offer you a permanent full-time position as a/an Production Manager, effective October 1, 2018. The following are the terms that will govern your employment with XYZ Inc. ("XYZ"). Once you have read and accepted the terms outlined below, this Offer of Employment shall be a binding contract.

1. **Employment:** XYZ will employ you and continue to employ you, subject to the terms in this Agreement. You will perform such duties and exercise such responsibilities as are assigned to you from time to time. In carrying out these duties and responsibilities, you shall comply with all policies, procedures, rules, and regulations, both written and oral, as are announced by XYZ.
2. **Compensation:** You shall be paid the rate of $45.00 per hour, less applicable statutory deductions for services rendered to XYZ, in accordance with standard payroll practices. Your rate of pay may be altered from time to time in the sole discretion of XYZ for business reasons.
3. **Probationary Period:** You will be subject to a probationary period of three (3) months, during which your performance shall be reviewed and a decision as to whether or not you will become a permanent employee shall be made.
4. **Confidentiality:** You shall keep confidential at any time during or after employment any information about the business and affairs of, or belonging to, XYZ, its customers, or suppliers, including, without limitation, information relating to pricing, customer identity, technical data, and market information.
5. **Non-Solicitation of Customers:** For a period of one (1) year following the termination of your employment with XYZ, you will not directly or indirectly solicit business from any client or customer or potential client or customer of XYZ that was serviced or solicited by XYZ during the course of your employment within any region that XYZ conducts business.
6. **Termination:** Your employment with XYZ may be terminated as follows:

(i) XYZ may terminate your employment, at any time, for just cause, without providing you with termination pay, reasonable notice, or pay in lieu thereof. Just cause includes, but is not limited to,
   (a) a material breach of any of the provisions of this Offer of Employment;
   (b) non-compliance with XYZ policies, procedures, and operating guidelines; and
   (c) theft, fraud, or wilful misconduct.

(ii) XYZ may terminate your employment, at any time, without just cause for any reason whatsoever, by providing you with such minimum amounts for notice of termination, benefits, and/or severance or payment in lieu thereof, as prescribed by the *Employment Standards Act, 2000*, that are applicable as of the date of termination. These entitlements are full and final and are inclusive of all entitlements under the common law.

(iii) You may terminate your employment with XYZ, at any time and for any reason whatsoever, upon giving XYZ two (2) weeks' prior written notice.

7. **Assignment:** The terms and provisions of this Offer of Employment may be assigned by XYZ at its sole discretion.
8. In the event that any provision or part of this Offer of Employment is deemed by a court to be invalid, the remaining provisions, or parts thereof, shall remain in full force and effect. This Offer of Employment, and the policies referred within it, constitute the entire agreement between us.
9. By signing this document, you acknowledge that you understand the terms of this Offer of Employment and that you had the opportunity to seek and obtain independent legal advice with regard to the execution of this Offer of Employment and the meaning of the provisions contained within it.

We welcome you on board and look forward to a lengthy and productive relationship. If this Offer of Employment is acceptable to you, please sign and return one copy of this letter to the undersigned by September 21, 2018 .

Yours very truly,

XYZ Inc.

I have read, understand, and agree with the above. I accept employment on the terms and conditions noted above.

_____ _____

Employee's Signature Employer's Signature