01 May 2013

Aim at perfection in everything, though in most things it is unattainable. However, they who aim at it, and persevere, will come much nearer to it than those whose laziness and despondency make them give it up as unattainable. - Philip Dormer Stanhope, 4th Earl of Chesterfield, Letters to his Son.

The fundamental legal relationship between employer and employee is one of contract. As lawyers, we encourage our clients to have written agreements in order to avoid misunderstandings and disagreements regarding what the parties intend. Despite these good intentions, case law is replete with examples of drafted agreements where parties have dramatically different interpretations of their respective rights. The purpose of this paper is to outline the twelve most common avoidable drafting errors and to propose possible "fixes" where an error has occurred.

Error #1 - Lack of Consideration

While arguably less of a "drafting" error than a procedural error, the most common technique used by employees to avoid the scope and ambit of an employment agreement is that the agreement is not supported by "consideration." Consideration is the simple legal principle that each party to a contract must give and receive something in order to make a contract binding.

If an employee was already working for an employer at the time of the employment agreement, no "fresh consideration" exists for the written employment agreement. The old legal adage "past
consideration is no consideration" often serves to defeat employers' expectations.

Traditionally, the court held that the right to continued employment was consideration enough for the enforceability of a written agreement executed after the start of employment. Occasionally, courts have held that where an employer has the legal right to terminate employment, the employer's decision not to exercise the right to terminate the employee is sufficient consideration for the enforceability of the agreement.

The vast majority of courts, however, have implicitly and explicitly rejected "continued" employment as sufficient consideration or have restricted the applicability to very narrow circumstances.

A relatively modern analysis of the doctrine is found in Hobbs v. TDI Canada Ltd. Allan Hobbs was actively recruited by TDI Canada Ltd. While interested, he made it clear that he would not resign from his current employment without a firm written offer. A simple offer was drafted and covered start date, job title, advance on commission, statutory holidays, vacation and benefits. Although the parties had negotiated a commission structure, the offer letter merely advised that rates, calculation and payment terms would be provided in a separate document. A detailed confidentiality agreement was also included. Both the offer and the confidentiality agreement were signed by Allan Hobbs. Mr. Hobbs started employment on January 4, 2000 and was subsequently presented a document entitled "Solicitor's Agreement." Mr. Hobbs was explicitly advised that the terms and conditions were "non-negotiable" and that if he wanted to be paid the commissions he had already earned, he had "no choice" but to sign the agreement.

A dispute arose regarding when commissions would be paid. TDI Canada relied on the restrictions in the "Solicitor's Agreement" and refused to pay anything but the basic draw and car allowance until the clients had paid TDI Canada in full. Allan Hobbs resigned on the basis that TDI Canada's conduct was not pursuant to his original understanding of the commission terms and ultimately sued for the commissions he felt were owing to him, approximately another $53,000.

Although TDI Canada was successful at trial on the basis that it was clear that Allan Hobbs would have been fired had he refused to sign the agreement, the Court of Appeal disagreed. Relying on a 1994 decision, Francis v. Canadian Imperial Bank of Commerce, the court concluded bluntly:

Francis makes it clear the law does not permit employers to present employees with changed terms of employment, threaten to fire them if they do not agree to them, and then rely on the continued employment relationship as the consideration for the new terms.

In addition to the outstanding condition of $52,778.81 in commission and interest, TDI Canada
was liable to pay over $85,000 in legal costs.

In my opinion, the best analysis which tries to resolve the inherent tension between the depression-era decision of the Supreme Court of Canada in Maguire and the more modern cases in the Ontario Court of Appeal in Francis, is Madame Justice Molloy's analysis on an interim injunction application in Kohler Canada Co. v. Porter:

> The principles of law set out in Techform and Maguire are, of course, applicable and binding upon me in this case. However, the facts of the case before me are strikingly different from those before the courts in Techform and Maguire. In this case, there is no evidence that Mr. Porter thought he would be fired if he did not sign the employment agreement presented to him … nor is there any evidence that Kohler said anything to him about termination. … Kohler would not have been entitled at law to dismiss Mr. Porter for refusing to sign the agreement. Having been employed by Kohler for 13 years prior to that time, Mr. Porter would have been entitled to a significant period of notice, likely in the area of 12 months or so. … In the case before me, there was no consideration flowing to Mr. Porter in exchange for his promise to give up the right to work for any competitor of Kohler. The stated consideration of continued "employment status with Kohler and payment of salary during such employment" are things that Mr. Porter was already entitled under his existing employment relationship with Kohler.

In short, while an employer is entitled to take the position that "in order to continue the employment relationship, you must sign this agreement or you will be terminated," the threat of termination must be accompanied by an appropriate termination package or severance offer. Failing which, the contract is effectively signed in the face of an illegal threat of termination and for policy reasons, ought not to be enforced. From a practical perspective, however, employers are rightfully reluctant to threaten to terminate their productive employees and provide a package (or working notice) simply to obtain a signature on a contract.

A promotion, an increase in salary, a signing bonus, a new bonus plan, or a new stock option agreement may all be valid consideration for a new employment agreement. An excellent illustration of the role of additional consideration is found in the Ontario Court of Appeal decision in Clarke v. Insight Components (Canada) Inc. Mr. Clarke had commenced employment in July 1995. The employer instituted a company-wide policy in December 2000, that all senior management levels would be subject to a termination clause that stipulated statutory minimums only. In April 2001, Mr. Clarke was promoted to Managing Director for Canada with an enhanced compensation package. Several weeks later, he signed a written memorandum regarding the terms and conditions of employment which contained the termination provision. The trial judge found as a fact that when Mr. Clarke accepted the position of Managing Director, he was completely aware of the company-wide policy that required this termination provision and that it already formed part of his employment package. In short, the written memorandum
simply confirmed what Mr. Clarke already knew and had accepted. Although the Court of Appeal is somewhat vague on point, the written contract could be justified on two inter-related bases:

i. The written contract simply confirmed the verbal terms and conditions of employment already agreed to by the parties; and,

ii. The enhanced remuneration and promotion constituted fresh consideration for the written agreement.

The ideal situation is to ensure that all contracts of employment are executed well before the commencement of employment. This ideal is rarely achieved.

Where a contract has been executed after the commencement of employment, it may be appropriate to have the employee "re-fresh" the agreement in circumstances where there is true consideration, e.g., a promotion, bonus or salary increase that was not previously agreed-upon.

Frequently, corporate practitioners are faced with the situation that requests for "proper" employment documentation is being imposed from a third-party, e.g., a potential investor or purchaser. In those cases, practitioners are well-advised to explicitly consider the availability of third-party consideration and to ensure that the existence of such a situation is explicitly identified in the recitals to any employment documentation.

**Error #2 - Not Providing for Obsolescence**

Any employment contract should provide for obsolescence. The obsolescence of the original employment contract can be used to challenge the enforcement of the employment agreement. This is a critical issue when an employee has changed positions through the years since the original contract.

The courts have found that in such cases, the "stratum" of the original agreement does not exist and the contract terms of the original agreement is not enforceable. Employment contracts should be reviewed and revised on a periodic basis. Courts have routinely found that a contract will not be upheld or enforced unless it reflects the reality of the employment relationship, i.e., the employee’s current position. It has been found that promotions, geographical transfers, or significant changes to the responsibilities of an employee have all been held to dissolve the original "substratum" of the agreement. It should be noted that length of employment alone does not cause the agreement to become obsolescent, if the position and responsibilities remain static over the years.

A dramatic example of the application of this doctrine is found in the decision of the British
Columbia Supreme Court in Schmidt v. AMEC Earth & Environmental et al. In 1987, Jerry Schmidt executed an employment agreement that stipulated he would receive 150 days of notice (roughly 21 weeks) if he were terminated without notice. In 2003, he was terminated without cause and AMEC honoured its obligations under the 1987 contract. Since 1987, however, Mr. Schmidt had been promoted several times. AMEC had not cross-referenced the original agreement when granting these promotions. The Court also observed that the original agreement did not envision future promotions or changes to Mr. Schmidt’s position. After reviewing his age, seniority and the external job market, the court awarded Mr. Schmidt 22 months of compensation in lieu of notice. The total damage award with interest and costs was well over $200,000, instead of the $45,000 originally expected by the employer.

Counsel should consider building anti-obsolescence language into their agreements, particularly with respect to provisions that are likely to be contentious, such as termination clauses or restrictive covenants. A sample clause might be wording to the effect that "the terms and conditions of this Agreement shall govern the parties, regardless of the length of employment or any changes to the Employee’s position, compensation, title and regardless of whether such change is material or otherwise."

Another closely related problem is that corporations often transfer employees from one related entity to another, without any thought to the contractual formalities. As was pointed out in Cavaliere v. Corvex Manufacturing Ltd., a termination clause which may exist in a contract between an employee and a specific entity may not serve to protect a related entity.

**Error #3 - The incorrect use of fixed term or fixed-task agreements**

There are numerous employment precedents that are structured as a fixed-term employment agreement. Fixed-term or fixed-task contracts are certainly appropriate where an employer has a logical basis on which to limit the term of employment. Examples include:

1. Maternity leave replacement;
2. Hires for specific task or project, e.g., crowd control for a specific festival or project;
3. Grant-based project with definite completion dates;
4. Time-limited transition requirements, e.g., after a sale or acquisition.

Employers, however, are often under the illusion that where there is a fixed-term or fixed-task arrangement, they are protected from any obligation to provide notice or severance at the end of the employment. The starting point at common law is that an employer does not have to provide reasonable notice of termination if the employment relationship comes to an end in
accordance with the fixed-term or fixed-task arrangements. The common law's position starts with the logical assumption that since the employer and the employee are aware of the inherently temporary nature of the employment, the formality of notice ought not to be required.

In Ontario, there have been significant legislative amendments to the common law position. Regulation 288/01 of the Ontario Employment Standards Act, 2000 provides that where the fixed-task or fixed-term exceeds 12 months or where the employment ends before the end of the term or task, statutory notice is due. Furthermore, where the term has been extended more than 90 days beyond the original term, notice is due.

Also, there is no exemption for the payment of severance just because employment is for a fixed-term. The problem can be acute in the context of certain types of corporate transactions. Consider a typical asset purchase agreement, where senior executives with long service may agree to a two- to three-year term employment period with the acquiring entity to facilitate a smooth transition. While both parties probably assume that the end of the term will mark the end of the relationship, without provision of notice or payment of severance, this is not a legally-correct assumption.

The Act however, would require notice and a lump sum payment of severance that reflected the hypothetical executive's service, both with the vendor corporation and the acquiring corporation. Service at both entities would be considered by virtue of the successor employer provisions of section 9 of the Act. This may trigger a large payment that was not anticipated by the acquiring corporation. The best way to protect against such an unexpected gap is to ensure that at the time of the initial asset purchase, the executives receive an amount that represents the severance for the service provided to date or to recognize the issue and adjust the purchase price accordingly. Where there is a share purchase agreement, it may be appropriate to consider the future liability in negotiating the price.

Error #4 - When indefinite employment is disguised as a series of fixed-term contracts

Another common problem is the use of a series of fixed-term contracts, some of which are subject to an "automatic renewal" clause. In other cases, the contracts essentially run "back to back," creating a continuous chain of employment.

The Ontario Court of Appeal in Ceccol v. Ontario Gymnastics Federation dealt squarely with this issue. Diane Ceccol had worked continuously for almost 16 years with the Ontario Gymnastics Federation (OGF), pursuant to a series of written one-year term agreements. At the time of termination, the OGF tried to rely on the term clause as a basis for termination,
thereby avoiding the provision of reasonable notice or compensation in lieu thereof. The courts looked at the underlying reality of an employee who had clearly served without interruption for almost 16 years. The courts did not accept that the situation was truly that of a fixed-term employee and found that the relationship was one of a contract of "indefinite" employment.

Since the contract is found to be indefinite, the fundamental common law principle applies: "a contract of employment for an indefinite period is terminable only if reasonable notice is given." This presumption of reasonable notice can be rebutted only if the employment contract "clearly specifies some other period of notice."

It should be noted that many not-for-profits use term agreements, because of the uncertain nature of grant funding. Such organizations can ill-afford payment of huge amounts of notice. In the circumstances, careful attention must be paid to termination clauses in order to limit exposure as much as possible.

**Error #5 - Failure to have an "out" clause**

Where an employee subject to a fixed-term or task contract is dismissed without cause prior to the expiration of term or task, the employee's damages are the amount he or she would have been entitled to receive had the contract been fulfilled. Lawyers should make careful inquiries when asked to draft a fixed-term agreement as to whether there might be any circumstances short of just cause that would lead the employer to end the relationship earlier and if so, to make provisions for earlier termination. If so, it may be appropriate to create a hybrid agreement that ends on the earliest of:

- a. The expiry of the term, as pre-defined;
- b. The provision of notice, as prescribed in the Agreement.

**Error #6 - Assuming that the Employment Standards Act, 2000 applies**

While my earlier comments focused on areas where lack of attention to the Employment Standards Act, 2000 (Act) caused difficulty, an equally-common error is to assume that the Act deals with the issue and obviates the necessity of specific drafting.

Under section 54 of the Employment Standards Act, 2000, no notice or compensation in lieu of notice is required if an employee is terminated within the first three months of employment. Employers often assume that because of section 54, the first three months of employment serve automatically as a "probation period."
The Employment Standards Act, 2000 (Act) provides as follows:

54. No employer shall terminate the employment of an employee who has been continuously employed for three months or more unless the employer,

(a) has given to the employee written notice of termination in accordance with section 57 or 58 and the notice has expired; or (b) has complied with section 61.

Many employers are under a serious misapprehension that Ontario "law" inserts a three-month probationary period into all employment arrangements, verbal or written. To the contrary, Canadian courts have implied into every employment relationship for an indefinite term that the relationship can only be terminated by the employer on reasonable notice or for just cause. For example, a Manitoba Queen's Bench indicated that it would have given a manager with twenty-three days of service six months notice or compensation in the absence of an explicit contractual probationary period. There are numerous cases where employees with three or less months of employment have been awarded significant notice periods, much to the chagrin of the employer. In these cases, the employer ended up paying the employee much more for notice than it ever did for the work that the employee performed! In short, if the employer wants a probationary period, it must prove that the employee knew and accepted the probationary clause. The easiest way to discharge this onus of proof is to incorporate a well-worded probationary clause in the offer letter or employment contract. A failure to stipulate a probationary period may lead to significant damages being assessed if an employer determines that the employee’s performance, while not tantamount to "just cause" for dismissal, is not sufficiently promising to maintain in the workforce.

Error #7 - Layoffs

Ontario Regulation 288/01 stipulates that an employee on a "temporary layoff" is not entitled to statutory notice. Section 56(2) and 63(1) of the Act obviate the need to provide statutory notice or severance in cases of temporary layoffs. Under common law, however, there is no right to general right to lay an employee off on a temporary basis.

As such, employers who wish to retain flexibility in the workplace would be well-advised to explicitly maintain the right to lay off employees in accordance with the provisions of the Act. In the current recession, many employers were dismayed to discover for the first time that there is no "automatic" right to lay off employees due to economic hardship or loss of business and that a temporary layoff for purely economic reasons did not reduce or eliminate the need to provide
notice or compensation in lieu.

**Error #8 - The right to disciplinary suspensions, short of termination**

Unionized workforces are extremely familiar with the concept of progressive discipline, ranging from a verbal reprimand and usually proceeding to short unpaid suspensions and then finally progressing to termination. The right to suspend an employee due to misconduct has an uncertain status in Ontario. While there are some indications that the Ontario courts may recognize the wisdom of an intermediate step of discipline, short of termination for cause, the traditional position is that an employer cannot "suspend" an employee for disciplinary reasons unless it can establish that it had just cause for termination and chose to impose a lesser remedy instead. Accordingly, it may be appropriate to consider the inclusion of a right of suspension as part of an overall disciplinary policy in a contract of employment.

**Error #9 - We have a Policy on that!**

Human Resources departments often develop elaborate and important policies with respect to a plethora of legally-significant matters, ranging from intellectual property, workplace conduct and even matters relating to termination. In my view, the courts have taken two approaches on policies, depending on their nature. Where they deal with legal rights, such as rights upon termination or intellectual property, the courts have required that the employer prove that the policy is a binding contractual term of employment. In other cases, where the policies deal more with workplace conduct and rules, the courts have required that it be demonstrated that the employer has clearly communicated the policy to the employee and that the employee understands the consequences of a lack of compliance.

A good illustration of the requirement that a policy be proven to be part of the employment agreement is demonstrated by Ellison v. Burnaby Hospital Society, a decision of the British Columbia Supreme Court. Ms. Ellison was a nurse who had worked for Burnaby Hospital for 25 years and was terminated due to an overall restructuring of the nursing administration. 21 years after she had commenced employment with Burnaby Hospital, a policy was introduced regarding termination and severance. The policy was found buried in the benefits policies of the Hospital and afforded Ms. Ellison significantly lesser rights than at common law. The court required the party relying on the policy - in this case, the employer - to prove that both parties accepted the policy as a term of the contract. It should be noted that the courts typically require evidence of actual acceptance. Silence or acquiescence has been rejected as evidence of acceptance. Not surprisingly, the court found that Burnaby Hospital's policy did not apply and
awarded her notice at common law.

As a practical matter, contracts of employment should contain explicit references to any policies that are deemed to be contractually relevant. These policies should be provided to a candidate simultaneously with any offer of employment and should be expressly cross-referenced and incorporated by reference into the terms and conditions of employment. An excellent technique adapted by some Human Resources departments is to require that part of the offer includes the synopsis of the company’s policies and an acknowledgement in the contractual document that the employee:

a. Has read and understood the policies and agrees that his/her employment will be governed by such policies;
b. Acknowledges that the employer may, from time to time, amend, alter, change or delete policies to meet the business needs of the enterprise and that the employee agrees that upon receiving notice of such policies, his/her employment will be governed by such revised policies.

Error #10 - Termination Clauses or All Good Things Must Come to An End

It is not surprising that termination clauses are highly litigated. The employer has an interest in minimizing costs upon termination, while the employee seeks to maximize the severance package. Case law is replete with termination clauses that have been ignored, rewritten or considered void by courts. Given the limitations of time and space, I will focus on the most common avoidable errors.

Error #11 - Lack of Compliance with Statutory Minimums

Most practitioners are aware of the Supreme Court of Canada’s decision in Machtinger v. HOJ Industries Ltd., where the court ignored a two-week termination clause on the grounds of illegality and awarded a dismissed employee an award of reasonable notice under common law. Even where the termination rights appear to greatly exceed an employee’s rights under the Employment Standards Act, 2000, it is wise to include language that the employee is entitled to the greater of his or her rights under the Act or the Agreement. Furthermore, a "boilerplate" clause that provides that where the entitlements under the contract are less than what is provided for by the Employment Standards Act, 2000 or other statute, the minimums in the applicable legislation shall be substituted for the contractual provisions is a useful savings
The importance of ensuring that there is no possibility of non-compliance with the Employment Standards Act, 2000 is illustrated in the recent case of Wright v. The Young and Rubicam Group of Companies (Wunderman) where the court focused on a clause that set out a formula for payment of "base salary" that seemingly complied with the Act in terms of notice/severance pay, but also stipulated that "this payment will be inclusive of all notice statutory, contractual and other entitlements to compensation and statutory severance and termination pay you have in respect of the termination of your employment and no other severance, separation pay or other payments shall be made." The court ruled that the entirety of the clause was invalid, as it precluded any claim for benefits and evinced an intention "to treat the payment of base pay under the termination provisions as the totality of the employee's entitlements to compensation on termination, regardless of whether the contractual provisions met the statutory minimum or not." Referring to the Machtinger case, the entire clause was deemed invalid and reasonable notice was substituted for the contractual formula, which would have been in the neighbourhood of 13 weeks.

Error #12 - Sloppy Drafting

We have all reviewed contracts which state something to the effect that a terminated employee will receive "x weeks' notice per year of service or compensation in lieu." The difficulty is that the "compensation in lieu thereof" is often not appropriately defined. Employees often enjoy a package of compensation including:

1. Base salary;
2. Retirement benefits, either RRSP or pension contributions;
3. Car allowance;
4. Health, dental and prescription drug coverage;
5. Short- and long-term disability coverage;
6. Stock options or similar rights, such as Restricted Stock Units or Stock Appreciation Rights;
7. Bonus;
8. Commission;
9. Reimbursement of professional fees and dues; and
10. Reimbursement of professional education or tuition subsidy.

The use of the phrase "compensation in lieu" is simply not precise enough to deal with situations where an employee benefits from many types of compensation. Compensation in lieu should be specifically defined. The types of group benefits that will be provided beyond the termination date should be specified, since most group insurance plans will not permit disability and out-of-
country travel to be extended beyond the Employment Standards Act, 2000 period.

There can be dangerous surprises lurking in stock option agreements, many of which restrict vesting and exercise rights post-termination. Unless the employment agreement is unambiguous, the courts will imply an obligation to compensate an employee for the loss of stock option benefits during any contractual or common-law notice period. Even where the pension or stock option document purports to limit accrual of benefits to active service, the over-arching employment agreement will be found to provide the employee with a right to damages. As such, it is important to ensure that termination clauses explicitly describe what rights exist or do not exist upon termination.

**Conclusion**

Numerous checklists exist with respect to employment agreements; I have attached my short-form checklist. I started this paper about the unattainability of perfection and end with a quote that is somewhat more encouraging:

> I am careful not to confuse excellence with perfection. Excellence, I can reach for; perfection is God's business.

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