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Employers Beware: In 2015, Your Firm's Termination Clause May Suddenly Have Become Unenforceable!

Alan Riddell and Kyle Van Schie

Is the termination clause in your organization's employment agreement template still legally enforceable? When asked that question, many CEOs and HR managers reply that they are certain it must be enforceable because it was drafted, or vetted, by a reputable law firm within the last few years.

Alan Riddell

Before you answer in the same way as those other CEOs and HR managers, consider this: a recent informal survey of the current employment agreement templates of 50 Ottawa companies revealed that more than half of those companies were unwittingly using termination clauses that had originally been drafted by lawyers, but that were null and void, and hence no longer enforceable.

This is because recent developments in Ontario employment law have now struck down many standard company termination clauses which were drafted by competent legal counsel several years ago and which, at that time, were widely considered to be legally water-tight. As a result, any termination clause which your company's trusted employment lawyers once assured you was fully enforceable may now, in 2015, no longer be worth the paper it is written on.

Kyle Van Schie

Operating your business without currently enforceable termination clauses can ultimately prove to be very costly to your company's bottom-line. Without such a clause, your company may be obliged to pay 1 or 2 *months* of salary per year of service, and sometimes more, every time someone is terminated. On the other hand, if your company is using a properly drafted, and still currently enforceable, termination clause, the law generally requires it to pay its terminated employees only 1 or 2 *weeks* of termination pay per year of service. As a result, the dollar cost to your company of terminating staff without a valid termination clause is astronomically greater than it is if you do so with a clause that is valid!

Given the significant financial stakes involved, it behooves all responsible CEOs and HR Managers to make absolutely certain that their company's termination clause is still legally valid and fully enforceable.

How certain can you be that your company's termination clause is still enforceable in 2015?

As most HR managers know, a company's termination clause is void *ab initio*, and legally unenforceable, whenever that clause provides for payment of less money than what is explicitly prescribed in the Ontario *Employment Standards Act* ("the *Act*"). As stated by the Supreme Court of Canada 25 years ago, in its seminal decision in *Machtinger v. HOJ Industries*, whenever a company's termination clause is void ab initio, the employer is legally obliged to pay all terminated employees full Common Law pay-in-lieu of notice, just as if the termination clause had never even existed in the first place ("the Machtinger rule").

What many HR managers do not know, however, is that in a recent series of court decisions, handed down over the past 4 years, the Ontario Superior Court has suddenly and very dramatically, extended the Machtinger rule to invalidate a large swathe of recently drafted termination clauses that most lawyers had believed to be watertight and enforceable.

In one of those recent decisions, *Wright v. Young and Rubicam Group of Companies*, the Superior Court ruled that any company's termination clause will be null and void if it has the potential to fall short of any aspect of the termination provisions of the

Act, regardless of whether or not such provisions actually infringed the Act at the time of the employee's termination. In this case, the termination clause provided all the company's dismissed employees with a relatively generous severance pay formula of 2- 3 weeks of salary per year of service. Wright himself, the dismissed plaintiff, had 5 years of service and the company's termination clause entitled him to 13 weeks of salary – that is to say to more salary than the termination and severance pay provisions of the Act required his employer to pay him!

However, due to a minor error of calculation committed by the lawyer who drafted the clause, that same contractual severance formula also provided for slightly less pay than the *Act* required be paid to Wright in the hypothetical eventuality that he had remained with the company for another few years. Although the pay formula in the company's termination clause provided Wright himself with more money than the company was statutorily required to pay him at the time of his termination, the Court nevertheless declared the entire clause to be void *ab initio* because its wording, hypothetically, had the future potential to contravene subparagraphs of the *Act* in minor ways that had absolutely no present application to Wright himself.

In a second recent decision, *Stevens v. Sifton Properties Ltd.*, the Superior Court pushed the reasoning in *Wright* one step further by ruling that any termination clause is now invalid if it fails to clearly and unambiguously provide for continued benefits coverage during the period of statutory notice prescribed in the *Act*. In that case, the company's termination clause was silent as to whether or not dismissed employees would be provided with benefits coverage during the notice period, and the employer had voluntarily – and generously – elected to provide the dismissed employee with full benefits coverage for that period, even though it was not contractually required to do so. Despite the employer's generosity, and solely because the termination clause itself failed to explicitly confirm that benefits coverage had to be continued, the Court declared the entire clause to be void *ab initio*, with the result that the dismissed employee became legally entitled to Common Law pay-in-lieu of notice.

In the wake of *Wright* and *Stevens*, which company termination clauses have now become legally unenforceable in 2015?

Based on the Ontario Superior Court's new reasoning, in *Stevens* and *Wright*, it now appears that the Court will strike down, as unenforceable, any and all of the following termination clauses:

- All termination clauses which appear to *implicitly deny continued benefits coverage* to dismissed employees, even if the employer had absolutely no intention of denying them such benefits coverage;

- All termination clauses which *do indeed* provide dismissed employees with continued benefits coverage, but fail to do so for up to *16 weeks* following the date on which they receive written notice of termination;

- All termination clauses which explicitly provide dismissed employees with *a fixed lump sum payment of less than 42 weeks' salary* (that is to say less than 10.2 months' pay) regardless of how short their length of service with the company; and finally

- All *other* termination clauses which provide dismissed employees with escalating tranches of pay-in-lieu of notice based on years of service *where any single one of those pay tranches*, as in *Wright*, mistakenly falls below the aggregate termination pay and severance pay prescribed in the *Act* for employees of that number of years of service.

As of 2015, many of the recently drafted termination clauses which are currently being used by companies across Ontario fall into at least one of these 4 newly prohibited categories, and are therefore undoubtedly now void *ab initio*, pursuant to the Court's reasoning in *Stevens* and *Wright*.

What are the financial consequences to your business of operating without a valid termination clause in 2015?

In the long run, operating your business with a termination clause which is now void *ab initio*, and hence legally unenforceable, can have very onerous financial consequences for your company.

If the termination clause in your company's employment contracts has been properly drafted, and is still currently valid, then (subject to a few statutory exceptions) each time you terminate someone's employment, you need only pay him or her approximately 1 week of statutory termination pay per completed year of service, to a final cumulative maximum of only 8 weeks' pay."*

On the other hand, if your company's termination clause is now invalid, or if you never had such a clause to begin with, then you will be legally required to pay your dismissed employees full Common Law pay-in-lieu of notice, often amounting to 1 or more months of salary per year of service, to an effective maximum of 24 months' pay.

In dollar terms, the differential between operating your business with, and without, a legally enforceable termination clause in your company's employment contracts, or letters of hire, can be quite staggering. By way of illustration:

- A middle-aged managerial employee, who is paid an annual salary of $76,000.00, who has accumulated slightly less than a year's service and who is terminated without a valid termination clause would ordinarily be owed between 2 and 6 months' pay-in-lieu of notice – that is to say between $12,500.00 and $38,000.00; however, if that same managerial employee is terminated with a properly drafted, and still valid, termination clause, he is owed only 1 week of termination pay, amounting to a paltry $1,500.00;

- Even more strikingly, a sexagenarian managerial employee, who is paid an annual salary of $120,000.00, who has accumulated 35 years' service and who is abruptly terminated without a valid termination clause would be owed about 24 months' pay-in-lieu of notice – that is to say $240,000.00; however, if that same sexagenarian manager is terminated with a valid, and properly drafted, termination clause, he would normally be owed only 8 weeks' termination pay, amounting to a relatively paltry $18,500.00.*

As these two examples vividly illustrate, any CEO or HR manager who runs his business operations without an enforceable termination clause in his company's employment contracts, or letters of hire, is ultimately assuming an enormous – and

wholly unnecessary – costs mark-up for the company, which, on the specific facts of the second example above, amounts to a mind-boggling 1,300% (13 times) more than what the law would otherwise require the company to pay!

In the long run, by operating without a valid termination clause, HR managers and CEOs are unwittingly placing their companies at a significant competitive disadvantage with other firms in their industry which have taken the time to revise their clauses to ensure that they now comply with the decisions in *Stevens* and *Wright*. Even if your company usually terminates only a couple of employees each year, the costs differential between having a valid and enforceable clause in your employment contracts and having an invalid one (or not having one at all) can easily exceed $100,000.00 per year.

For this reason, any business-savvy employer or CEO who wants to avoid paying such colossal, and ultimately unnecessary, termination costs each year should promptly contact a reputable employment law firm, to ensure that his or her company's termination clause is immediately reviewed and revised to fully comply with the new rules recently enunciated by the Superior Court in *Stevens* and *Wright*. Such is a 'no-brainer' since the future annual costs savings to your company will far exceed the legal fees incurred in revising its termination clause to ensure full compliance with the recent caselaw of the Ontario Superior Court.

*This assumes that the employer's total annual payroll is less than $2.5 million, and that it is not terminating 50 or more employees in any single 4 week period. Otherwise, statutory severance pay and possibly mass termination pay would also have to be paid to the dismissed employee, pursuant to Sections 64-66 of the Act and 3(1) of Ontario Regulation 288/01.

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