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EMPLOYMENT CONTRACT PROVISIONS – PROTECT YOUR ORGANIZATION

1. Introduction

An unambiguous and clearly drafted employment contract can be one of the most important tools available to employers concerned with reducing future termination costs and other disputes down the road. A contract for employment will often govern how a court interprets the entirety of the employment relationship. Since any ambiguities in the contract will be construed in favor of the employee, who likely takes little part in its preparation, it is important that contractual provisions are clearly worded and stay onside with Ontario employment legislation, the *Employment Standards Act, 2000* ("**ESA**"). Some clauses, including probationary period clauses, termination clauses, and clauses that govern the provision of benefits, can be instrumental to keeping an employer's termination costs low. One other aspect of employment contracts which is often the subject matter of disputes are non-competition and non-solicitation provisions. These provisions also must be clearly worded and very specific to be enforceable.

2. Probationary Period Clauses

A probationary period can be a very effective tool for the employer. It allows the employer to escape costs associated with terminating an employee while he is being tested for his suitability for the position. The ESA provides for a probationary period. According to the ESA, the employment of an employee who does not meet the requirements expected can be terminated without notice or liability. However, employers should be careful not to assume that simply because the ESA provides for a probationary period, a contract for employment can omit a clause setting out the probationary conditions. Indeed, it is important that the employee's probationary status be detailed in the employment contract to ensure the employer can take advantage of this period. A probationary term will not be implied into the employment contract. In fact, employees who have been hired and then terminated before they have even commenced working have been provided with as much as 6 months of severance pay, in special circumstances[1] where the contract did not have a properly worded probationary period clause.

Where an employer wishes to use a probationary period to avoid wrongful dismissal claims from probationary employees, the employer should ensure a carefully drafted probation clause is included into the employment agreement. A few points to consider are:

- Terminology
- Length of probation term
- Purpose of probation term
- Probation as a disciplinary action

First, it is imperative that the term "probation" specifically be used. Second, with respect to the length of time, typically, employers will choose a three month probationary period since it often coincides with the employee's eligibility for group benefits. However, where the probationary period is longer than three months, the employer must be careful. The agreement should provide that the employee will receive the ESA minimum notice termination if he or she is dismissed after three months but within the probationary period. Otherwise, the provision may be considered null and void. Therefore a contractual provision could state, if, for example, an employer wishes to have a probationary period of 6 months:

> "The *employer may terminate the employment without cause or any form of termination payment within the first three months of probation and may terminate after three months by providing the minimum pay in lieu of notice provided by the ESA during the 6 month probationary period.*"

If the employer wishes to terminate his employment after 5 months, the employer must still provide a

1 *Rioux v. Pharmacie Edmunston Ltee (*1980), 34 N.B.R. (2d) 416 (Q.B.).

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minimum of one week's notice or payment in lieu of notice at the time of dismissal.

The specific purpose of the probationary term should also be set out in the contractual provision – i.e. the assessment of a probationary employee's suitability for the position. Where there is an unambiguous probation clause, an employer has the implied contractual right to dismiss a probationary employee without notice and without giving reasons, provided the employer acts in good faith in the assessment of a probationary employee's suitability.[2]

Finally, the employer may consider adding a provision that states that the employer can place the employee on probation as a disciplinary action. If the original employment contract is silent on the use of probation as a form of discipline, then an employer is precluded from doing so. Where this is the case, an employee that is subject to probation as a disciplinary measure may potentially claim constructive dismissal and sue for severance.

3. Limited Time Termination Clauses

Where an employee is terminated with cause, he is not entitled to notice or payment in lieu of notice. Cause for termination may include habitual neglect of duty, dishonesty, theft, fraud, conflict of interest, incompetence, disobedience or insubordination – but each of these bases of termination are fraught with difficulties for the employer and as such alleging cause is rarely effective except in clear cases. This is a topic unto itself and will not be addressed here.

Where an employee is terminated without cause, the ESA provides for a minimum notice period upon termination. However, the Canadian courts have consistently held that the standards provided for under the applicable provincial employment legislation, including the ESA, are deemed a minimum requirement only. A right, benefit, term or condition of employment under a contract, oral or written that provides in favor of an employee a higher remuneration than the requirement imposed by the ESA will prevail over the legislated employment standard. This means that where an employer wishes to limit an employee's rights upon termination, the following principles will apply:

- The contract cannot provide for less notice than is required under the provisions of the ESA or the provision will be null and void;
- The contract must specifically provide that the ESA applies. It should not simply say "provincial law." It must name the legislation; and
- Since the ESA states that the minimum notice will be "at least" a particular period of time, a contractual provision that merely states that notice will be in accordance with the ESA may not be clear enough.

The consequences of an ineffective termination clause can be quite costly for the employer. The Supreme Court of Canada has established that a notice clause in an employment contract for the termination of an employee must meet the minimum statutory requirements in the jurisdiction of employment.[3] If it fails to meet the minimum statutory notice requirement, then the common law period for reasonable notice will apply. Therefore, where a notice provision is found to be null and void, the common law will impose a greater reasonable notice period resulting in the employer paying a greater payment in lieu of notice. An employer can rebut the common law presumption of reasonable notice, however, by agreeing to an unambiguous notice of termination clause that complies with the ESA.

Where a contractual provision does not meet the minimum termination period provision in the ESA, which requires at least 8 weeks where employment exceeds 10 years, the contract contravenes the minimum employment standards and the contract can be considered null and void.[4] Where a specified notice period is included in the contract, the period should be long enough to meet any potential statutory notice period requirement. Any clause which provides for a specified period of notice may be held unenforceable even if the employee has not been employed for the requisite amount of time to be entitled to that period of notice as the clause will still eventually result in notice that is less than the statutory minimum. Therefore the contractual provision should include the following phrase:

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2 *Jadot v. Concert Industries Ltd.* (1995), 10 C.C.E.L.
3 *Machtinger v. HOJ Industries Ltd* [1992] 1 S.C.R. 986, (1992), 91 D.L.R. (4th) 491 (S.C.C.)
4 *Collins v. Kapele, Wright & MacLeod Ltd.* (1983), 3 C.C.E.L. 228, 1983 CarswellOnt 775 (Ont. Co. Ct.), carried (1984), 3 C.C.E.L. 228 at 240 (C.A.).

"Should you be terminated for reasons other than cause, then you will be entitled to a minimum of 8 weeks notice, or pay in lieu of notice, or such that is required by the Employment Standards Act, whichever is greater".

While again not the topic for this article (as it is another topic unto itself), contract changes made AFTER employment has already commenced that could be considered to be to the detriment of the employee – i.e. attempting to limit common law rights to lesser contractual terms, must be in exchange for independent consideration of some kind to be legally effective, even if accepted by the employee.

4. Benefits Clauses

According to the Ontario Ministry of Labour policy, continuation of the employment relationship does not require active employment. Additionally, it is possible that benefits such as automobile benefits, housing allowances, stock options, or any other ancillary benefits can form part of the employment contract whether or not they are contained in the same contract. The courts have held that such benefits form a part of the employee's integral benefits package where the employee has a reasonable expectation of receiving them during employment.

Any of these ancillary benefits that are associated with personal use are expected to continue into the notice period, if the employer does not contract otherwise. For instance, where an automobile benefit is given where the intent is clear that use of the automobile is for the business purposes only, the benefit will end upon the period of active employment. However, where a personal benefit is given, such as an employee stock option, the ability to exercise that stock option will continue into the notice period. With respect to stock options, it is possible that even where an employee is required by agreement to sell his shares upon termination of his employment, the value of the dividends on such shares during the period of notice can be considered a proper head of damage for wrongful dismissal.

This can become very expensive for the employer. If, for instance, a director is dismissed without cause and his contract for employment provides a stock option to be exercised within 30 days, the director has 30 days after the end of the notice period to exercise it. Depending on market conditions, this could be quite costly for the employer corporation. Therefore, a clause that grants benefits to an employee should specify that benefits given under the agreement will cease upon the employee ceasing his or her period of "active employment."

Where a stock option agreement makes rights and obligations dependent on when an employee ceases to be an employee and the wording is ambiguous, the provision will generally be construed in favor of the employee. However, where the agreement between the parties is found unambiguous and clearly meant that the rights ended on the date of dismissal then the agreement will prevail.[5] Otherwise, stock options will vest during the reasonable notice period to wrongfully dismissed employees.

5. Equity Participation or Profit Sharing Plans

Some employers use profit sharing or equity participation programs as an alternative to paying bonuses and/or granting share purchase options. These plans generally distribute a grant to highly valued employees, usually annually, that accord with the employers' increased profits within the relevant period. However, these schemes can sometimes be ambiguous with respect to the date of vesting and date of grant terms. In one case, an employer awarded to an employee "annual grants" that "vested over 3 years" up to an amount equivalent to 5 % interest in the company. The employee was terminated after 12 weeks. The court determined that at the date of termination no portion of the grant had vested and the employee was not entitled to anything under this clause of the agreement. In agreements such as these, it is important that both the "date of grant" and "vesting" terms be very specifically defined so as to accurately determine an employer's anticipated termination costs.

6. Non-Solicitation Covenants and Non-Competition Clauses

The purpose of a non-solicitation covenant is to prevent an employee from soliciting customers with whom he or she did business while employed by that employer. It is often the case that an employee will develop close personal relationships with the employer's customers that the employee would not

5 *Brock v. Matthews Group* (1991), 34 C.C.E.L. 50 (Ont. C.A.)

have otherwise developed. In general, non-solicitation covenants are more enforceable than non-competition clauses.

The more troublesome contractual provision is the non-competition clause. In fact, a recent Ontario decision has held that a non-solicitation covenant that is joined with an unenforceable non-competition clause will also be unenforceable. A non-competition clause is a provision that prevents an employee from competing with the employer by joining a competitor organization or by establishing a competing business. Where an employer uses a non-competition clause, they do so at their own peril. Many of these clauses have been held by the courts to be unenforceable against employees in their capacity as employees as a restraint on trade. Furthermore, if an employer relies upon an aptly crafted non-solicitation covenant for a specific time limit, a non-competition clause may be unnecessary.

However, there are a few exceptional circumstances where a non-competition clause may be enforceable and appropriate. These clauses should be very restrictive in time and scope. There are four principles that govern whether a non-competition clause will be enforceable. First, the employer must have a legitimate interest that requires protection. A legitimate interest must be something greater than an inclination to prevent competition. For instance, the employer may have valuable trade secrets or confidential information that it seeks to protect. Second, the clause must be restrictive in scope so as not to provide the employer with more protection than is reasonably necessary. Third, the clause should have a limited time, geographic area, and competitive activity specified. Finally, the courts will consider whether enforcing the clause would be in the public's interest.

7. Tricky Terminations – Terminating a Key Executive

Termination of executive employees is always a tricky area and generally should be carried out in a carefully planned manner whether or not the termination is with or without cause and irrespective of whether the employer intends to honour the terms of the employment contract between the employer/employee.

Complications may include:

1. Executive may have company property at the employee's home or registered in his/her name – issues of return of company property;
2. Executive may be entitled to lengthy benefits and notice of termination at law – termination is expensive; and
3. Employee may hold board/officer positions and titles within the company itself and/or its subsidiaries.

Anytime a company wishes to terminate a key executive, the contract with that executive should be reviewed in advance by legal counsel who is fully informed of the circumstances surrounding the ties of the executive to the company, its business and its assets to ensure that the termination is carried out in a manner that is the most beneficial to the company in the circumstances.

8. Conclusion

Given the complexity of even the most seemingly simple provisions, obtaining correct legal advice in advance of hiring or with fresh consideration is imperative in crafting contracts for employment. With a proper contract for employment an employer can ensure that it has proactively taken steps to save some of the future costs associated with termination.

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6. *Madison Chemical Industries Ltd. v. Walker* (2000), 4 C.C.E.L. (3d) 133 (Ont. S.C.J.)
7. *Elsley v. J.G. Collins Insurance Agencies Ltd*. (1978), 83 D.L.R. (3d) 1 (S.C.C.)
8. *Beaver Brokerage Inc. v. Williams* (1989), 103 N.B.R. (2d) 314 (Q.B.)