

## **Mind the Gap: Making Valid Employment Contracts Your #1 HR Priority**

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### **Introduction**

Just as commuters are urged to “mind the gap” when stepping from a subway platform onto an outbound train, so too employers are reminded to do the same when contemplating an employee termination.

### **The “Gap”: What Falls Between Common Law and Statutory Termination Pay**

In the employment context, the “gap” relates to financial danger rather than personal safety; specifically, the gap between the generous common law notice payments that courts often say employees should be paid upon termination, and the minimum amounts of notice and severance pay that employment standards legislation says employees must be paid.

What is not apparent to most employers, however, is that unless a valid employment contract states otherwise, the law’s default position is that a dismissed employee will generally be entitled to receive the more generous payments under the common law.

An employment contract, whether implemented at the hiring stage or validly imposed afterwards, can be an invaluable opportunity to fill this gap with notice and severance terms that protect your organization with predictable and manageable termination costs, while still providing fair compensation to employees at their time of dismissal.

### **Requirements for Legal Compliance**

Courts will only enforce contractual termination provisions if they are compliant with applicable law. This means that:

- The termination provision cannot provide the employee with less than what he or she would receive under the applicable employment standards legislation;
- The employment contract itself must be supported by valid consideration;
- Given all the circumstances, the termination provision must be clear and unambiguous.

If both the termination provision and the employment contract itself are legally sound, the contractual terms will oust the employee’s common law notice entitlement, and the stated terms of the employment contract will govern.

### **Recent Example: No Unjust Dismissal if Terminated per Employment Contract**

A recent case decided under the federal *Canada Labour Code* (the “Code”) demonstrates how employment contracts can minimize an employer’s legal liability to a dismissed employee.

In *Klein v. Royal Canadian Mint Canada*,<sup>1</sup> an employee was required to sign an employment agreement when he was promoted out of the unionized bargaining unit and into a supervisory position. The agreement stated that:

“... [f]ollowing your probationary period, should your employment be terminated for reasons other than cause, it is understood that you will be entitled to two (2) week notice and not more than three (3) weeks of salary for each completed year of service[.]”

These terms were more generous than the minimums under the *Code*, but less than what a court would likely award for reasonable notice under the common law. In particular, the Code only required two weeks’ notice of termination and severance pay of five days wages plus two days’ wages per year of service.

After three years in the supervisory position, the employee was terminated without cause. Rather than accept the payments set out in the employment contract however, the employee claimed his termination was “unjust” and filed a request under the *Code* for reinstatement.

The adjudicator appointed under the *Code* held that the employment contract was controlling of the dispute, stating that:

“[The employee] freely entered into an employment contract for the purpose of career advancement. He had the option of remaining in his bargaining unit job. ... The new position paid a substantially higher salary and carried additional responsibilities. It also removed [him] from the protection of the collective agreement and substituted the terms of an individual contract[.] ... The contract as written was clear and succinct.

When the employer opted to terminate without cause, it fulfilled the bargain by offering the requisite severance...[t]he May 2010 offer is still open and this undertaking by the Mint forms part of my determination that the dismissal is not unjust.”

### **Beware the Hiring Contract Presented After the Employee Starts Work**

For an employment contract to be valid (assuming compliance with employment standards legislation), the timing of the offer and acceptance is critical. This is because a contract requires valid consideration to be enforceable.

For example, if an employee is asked to sign a contract limiting termination entitlements after his or her hire date, enforcing that contract will be an uphill battle. Courts will typically view this as a modification of an unwritten but implied common law contract governing the employment

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<sup>1</sup> [2012] C.L.A.D. No. 358 (Peltz).

relationship from the outset. As a result, some sort of additional monetary benefit will be required as consideration for the existing employee's agreement to the new written contract. This is the case even if the timing of presenting the contract was simply an administrative oversight. (And no, telling employees they can keep their job if they sign the new written agreement is not valid consideration!)

Apart from consideration and timing, the other challenge to implementing a valid written employment contract for an existing employee is ensuring that the employee has an opportunity to review and understand its terms prior to signing. For example, an offer letter that refers to a termination provision in an employee handbook or company policy will typically be unenforceable unless the relevant handbook or policy excerpt was provided to the employee along with the offer letter. Put another way, courts will not enforce contracts which require employees to agree to terms of employment that they have been unable to review.

### **Transitioning Existing Employees onto Valid Employment Contracts**

If no employment contract was presented at hiring or if there is reason to doubt a contract's enforceability, how can employers rectify the situation? Consider the following:

- Tie any offer of promotion to the signing of a new employment contract. Courts have found valid consideration in the enhanced position and increase in compensation which generally accompany a promotion.<sup>2</sup>
- Be wary of tying annual compensation adjustments to the signing of new employment contracts. If the employee can show that he or she would still have received the raise without signing the contract, the consideration may be invalid.
- Signing bonuses can be valid consideration for an employment contract presented to an existing employee. Although courts do not inquire into the quantum of consideration, a meaningful amount should be offered in order to compensate the employee for the loss of his or her common law termination entitlements.

But what if, even after offering valid consideration, an existing employee still refuses to sign a contract modification? This was precisely what occurred in *Wronko v. Western Inventory Services*,<sup>3</sup> the governing case on this issue in Ontario.

### **Dealing With Employees Who Refuse to Sign: The *Wronko* Lesson**

In *Wronko*, the employer gave two years' advance notice of its desire to change the termination provision in the employee's employment contract. The termination clause in the existing contract granted the employee two years' severance and the employer wanted to reduce it to thirty weeks.

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<sup>2</sup> See *Clarke v. Insight Components (Canada)*, 2008 ONCA 837.

<sup>3</sup> 2008 ONCA 327.

Two years passed, during which the employee repeatedly refused to accept the new severance provision. After two years, he was presented with the new contract for his signature and was told that, "If you do not wish to accept the new terms and conditions of employment has outlined, then we do not have a job for you." The employee considered himself terminated and made a claim under the two-year severance pay provision in his original contract.

The Ontario Court of Appeal ruled in the employee's favour, as given his repeated refusals, it could not be said that there was any true offer and acceptance of the new employment contract. This signaled a departure from the traditional means of implementing changes to employment contracts, where employers could simply offer advance notice of a change it sought to implement.

As a result, the Court held that an employer has two options in dealing with an employee who refuses to accept a change to his or her terms of employment.

1. The employer can acquiesce to the employee's refusal, meaning that the original terms and conditions of employment will continue to apply; or
2. The employer can terminate the employee with proper notice and then offer re-employment on the employment contract it seeks to implement.

Applied to the facts before it, the Court held that in light of the employee's stated refusals, in order to implement the new contract with the modified severance provision, the employer should have terminated the employee with proper notice and offered to rehire him on the contract's new terms.

## **Conclusion**

We cannot stress enough that written employment contracts containing clear termination provisions should be a critical piece of an employer's strategy to contain termination costs and limit overall liability. When properly drafted and implemented, such provisions clarify at the outset what employees will be entitled to at termination and, in doing so, facilitate smoother departures for both employers and the employees in question. Although courts impose hurdles to enforceability, when an employer can show that it took all the proper steps to draft and implement a contract, the case law shows that they are frequently upheld.

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