Goodmans LLP Update

Recent Ontario Employment-related Decisions Heavily Favour Employees

A number of recent cases decided by the Ontario Superior Court of Justice and the Ontario Court of Appeal are changing the likely outcomes of wrongful dismissal litigation in Canada in favour of employee plaintiffs. These rulings make it easier for employees to establish that their contractual termination rights are unenforceable and to claim reasonable notice at common law in connection with a wrongful termination. The courts considered the power imbalance between employer and employee and indicated that any drafting ambiguities will be resolved in the employee's favour, and even unambiguous drafting may be interpreted in an employee's favour if the employer failed to consider and expressly provide for potential changes in the employment terms that may never be realized.

Below are summaries of four recent decisions which may fundamentally change an Ontario employee's rights on a termination of employment without just cause. It is likely the termination provisions contained in the majority of employment contracts drafted before June 2020 (when the first of these cases was decided) may now be unenforceable. It is clearly essential that employers amend their employment agreements with current employees as needed (providing "fresh" consideration for any amendments), and revise their employment agreements for future hires, to provide for enforceable termination rights and ensure employees understand these termination rights before signing. Employment agreements should also include a broad "savings" provision with a clear waiver of common law reasonable notice by the employee and which provides that an employee will never receive less than the required statutory minimums under employment standards legislation, regardless of any future changes to the employee's position, to the size of the employer's business and any future amendments to applicable employment standards legislation. Employers in M&A transactions will also need to be careful in making any seller or buyer representations to employees about the terms to govern an employee's post-transaction employment and the termination of such employment.

1. Waksdale v. Swegon North America Inc. ("Swegon") (June 17, 2020)

In *Waksdale*, the Ontario Court of Appeal limited the applicability of severability clauses, and determined that termination rights must be read together. An otherwise enforceable without cause termination clause in an employee's contract will be void if the termination for just cause provision is unenforceable.

Background

Swegon terminated Mr. Waksdale without cause on October 18, 2018. Mr. Waksdale sued for wrongful dismissal claiming common law reasonable notice damages, despite having signed an employment contract which limited his entitlement on a termination without cause to one week's notice of termination (or pay in lieu) plus the statutory minimum entitlements under the *Employment Standards Act, 2000* (the "**ESA**").

Mr. Waksdale's employment contract contained provisions addressing termination with and without cause. It also contained a severability provision, which explicitly purported to separate any invalid provisions from the rest of the contract. Swegon conceded the termination with cause provision violated statutory minimums set out in the ESA and Mr. Waksdale conceded the termination without cause provision was valid. The trial judge held no damages were owed to Mr. Waksdale because Swegon relied upon the valid stand-alone termination without cause provision to terminate Mr. Waksdale, not the invalid termination for cause provision.

Authors

Susan Garvie
sgarvie@goodmans.ca
416.597.4141

Tom Spelt
tspelt@goodmans.ca
416.849.6007

Ontario Court of Appeal Decision

The Ontario Court of Appeal held the trial judge erred in considering the invalid termination with cause provision in isolation from the rest of Mr. Waksdale's employment contract and ruled that "[a]n employment agreement must be interpreted as a whole and not on a piecemeal basis. The correct analytical approach is to determine whether the termination provisions in an employment agreement read as a whole violate the ESA." The Court of Appeal mentioned the power imbalance between employers and employees and ruled that the illegality of the termination with cause provision rendered *all* of the contract's termination provisions unenforceable, notwithstanding the termination without cause provision was entirely valid absent the illegal termination provision.

The Court of Appeal considered the enforceability of the termination provisions at the time the employment contract was drafted, rather than at the time of termination, determining that all termination provisions were invalid and unenforceable *ab initio*. The fact that Swegon never tried to rely upon the illegal termination with cause provision was therefore irrelevant.

The Court of Appeal also declined to enforce the severability provision designed to "save" the rest of the agreement if any particular term was deemed to be invalid or illegal. It held that severability clauses of this kind cannot apply to any provision in an employment agreement which would have the effect of contracting out of the ESA provisions.

Implications for Employers

The Court of Appeal's decision in *Waksdale* could potentially be very disruptive and costly for Ontario employers. It may render many existing termination provisions unenforceable. The recognition that just cause provisions are unlawful if they contract out of ESA entitlements is a fairly recent development and many employment agreements provide that employment may be terminated for just cause without notice or payment (without an exception for payments owed under the ESA). Recent case law has determined that termination without cause provisions are illegal if they attempt to contract out of ESA entitlements, including by excluding benefits continuance or severance pay from the termination without cause provision or providing that severance pay can be satisfied by working notice of termination. However, *Waksdale* is the first decision where a termination without cause provision, which complied with the ESA and was otherwise enforceable on its own, was rendered unenforceable because of a separate invalid termination for just cause provision, where there was no allegation of just cause and the employment contract contained a severability provision.

By reading Mr. Waksdale's termination provisions as a whole, the Court of Appeal eliminated the protection severability provisions previously offered to employers. It is possible that if this reasoning is followed and expanded so that restrictive covenants must be read together, then an overly broad and unenforceable non-compete could render an otherwise valid non-solicitation or non-interference covenant unenforceable.

Ontario employers should review their current employment agreements to ensure that *both* the termination for cause and termination without cause provisions comply with the ESA and consider amending their templates to increase the likelihood of enforceability. They should also amend agreements with current employees which may not contain unenforceable termination provisions at the first opportunity in exchange for "fresh" consideration (for example, by specifying that a termination for cause may be implemented without notice or payment, except as may be required under ESA), and by adding a savings provision which clarifies that in no event will an employee receive less than employee's statutory minimums under ESA.

2. Battiston v. Microsoft Canada Inc. ("Microsoft") (July 15, 2020)

The Ontario Superior Court of Justice in *Battiston* held that employers must give employees sufficient notice of "harsh and oppressive" termination provisions in their equity-based incentive plans, failing which limitations on employee rights in compensation arrangements may be unenforceable.

Background

Microsoft employed Mr. Battiston for 23 years before he was terminated without cause in August 2018. Mr. Battiston received part of his

compensation from Microsoft in the form of merit increases, cash bonuses and annual stock awards under Microsoft's rewards policy, which unambiguously stated that "an employee's rights to unvested stock awards would terminate upon the termination of that employee's service." Microsoft had previously informed employees of this termination condition by sending them an annual email (a) advising they had received a stock award, (b) instructing them to complete an online acceptance process, and (c) informing them that completion of this acceptance process would demonstrate they "read, understood and accepted the stock award agreement" and accompanying documents.

Upon his termination, Microsoft informed Mr. Battiston that all of his unvested stock awards were null and void, pursuant to Microsoft's rewards policy, and that he would not receive a merit increase or bonus for 2018. Mr. Battiston claimed to be unaware of this termination condition, and maintained he expected to be able to cash out his granted but unvested stock awards. Mr. Battiston testified that although he received Microsoft's annual rewards policy emails, he always completed the online acceptance process without reading the long underlying stock awards documents. Microsoft did not dispute that it had not specifically drawn Mr. Battiston's attention to the termination provisions in its rewards policy.

Ontario Superior Court Decision

The Court held that Mr. Battiston was entitled to damages for his stock awards that would have vested during his termination notice period, notwithstanding Microsoft's rewards policy "unambiguously" removed Mr. Battiston's right to continued vesting of his stock awards after his termination without cause. These termination provisions were unenforceable because Microsoft had not taken "reasonable measures"[1] to direct Mr. Battiston's attention to the rewards policy termination provisions. Notably, the Court did not find the termination provisions unenforceable due to their "harsh and oppressive" nature in limiting his right to continued vesting of his stock options.

Implications for Employers

Battiston presents a change to the way employers must communicate with their employees to create enforceable employee compensation arrangements. It is common practice for employers to limit an employee's common law rights to damages on a termination without cause, and in particular, to limit rights to receive bonuses or stock options or other equity incentive grants during the notice period and to terminate unvested stock options on the termination date, subject to any ESA minimum notice period. It is not common practice to specifically draw limitations of an employee's rights in an employment agreement or compensation agreement to the employee's attention at the time of signing.

Following *Battiston*, employers should specifically direct their employees' attention to any provisions that may restrict the rights of employees to substantial elements of their compensation (including bonuses, stock options or other equity incentives). Employers should also consider whether to specifically point out any limitations on the employee's right to receive common law reasonable notice on a termination without cause and any restrictive covenants which might limit the employee's ability to earn a livelihood. To this end, employers should consider implementing all or some combination of the following:

- Circulate an executive summary expressly pointing out any "harsh and oppressive" provisions and describing the extent to which these provisions would limit an employee's entitlements on a termination of employment (together with a copy of the employment agreement, compensation agreement or plan document), particularly if these other agreements or documents are long and may be unlikely to be read;
- Explicitly include termination provisions in email communications with employees, rather than merely referring employees to stock awards agreements or plan documents;
- Require employees to initial beside any provisions that are potentially "harsh and oppressive" in an employment agreement or compensation agreement or plan document;
- Hold informational meetings for employees at which these termination provisions are highlighted and discussed; and
- Require employees to acknowledge they have read, understood and accepted rewards policy termination provisions *in particular*, rather than simply the conditions of a rewards policy as a whole.

[1] The Court decided that the annual rewards policy emails and online acceptance process used by Microsoft to inform employees of the terms of their stock awards did not constitute a reasonable attempt to alert employees to these termination provisions.

Following *Battiston*, it is unclear which common employment and compensation practices might be considered "harsh and oppressive" and must be specifically pointed out to employees to be enforceable. The case does not give guidance on what will be sufficient to draw these provisions to an employee's attention. Employers will need to follow future cases and appeals to gain more certainty that all necessary additional steps have been taken to create enforceable limits on the post-termination rights of their employees.

3. Rutledge v. Canaan Construction Inc. ("Canaan"), 2020 ONSC 4246 (July 9, 2020)

In *Rutledge*, the Ontario Superior Court of Justice established that even violations of the ESA based on remote, hypothetical fact scenarios may result in the invalidity of termination provisions in employment contracts.

Background

Mr. Rutledge was employed as a construction worker by Canaan intermittently from 2012 until 2017. His employment contract with Canaan specified he was a construction employee and set out the duties for which he was responsible. It also contained a termination provision in which Mr. Rutledge acknowledged he was not entitled to notice or pay and benefits in lieu thereof upon termination because he was a construction employee. In late 2017, Canaan temporarily laid off Mr. Rutledge and did not recall him. Mr. Rutledge sued Canaan for wrongful dismissal.

Construction workers are exempt employees who are not entitled to statutory notice of termination or termination pay in lieu of notice under the ESA. Employers who have a payroll of less than $2.5 million are not required to pay severance pay under the ESA to employees (including construction workers), with five or more years of service (except in a mass termination scenario). Mr. Rutledge did not dispute that he was not entitled to notice of termination, termination pay or severance pay under the ESA when he was terminated. Nevertheless, Mr. Rutledge argued the termination clause in his employment contract was invalid. The Ontario Superior Court of Justice agreed.

Ontario Superior Court Decision

The Court held that termination clauses can be void even in cases where they do not violate the ESA in light of the facts existing at the time of hiring and termination. That is, even if termination provisions only violate the ESA in theory, they can be void on the assumption that a hypothetical set of future circumstances might come into existence which could violate the ESA.

In Mr. Rutledge's case, the Court noted that if his employment duties for Canaan were to change at some point in the future, such that he was no longer considered a construction employee, then the termination provision in his contract would have denied him the termination notice or pay in lieu thereof to which he would otherwise have become entitled. Further, the Court observed that if Canaan were to expand as a business such that its payroll exceeded the $2.5 million threshold or it employed more than 50 persons and could theoretically implement a mass termination, then Mr. Rutledge's employment contract would have denied him the severance pay he would otherwise have been owed. For these reasons, the Court held that Mr. Rutledge's termination clause was void.

In arriving at this decision, the Court cited jurisprudence stating that "if a provision's application potentially violates the ESA at any date after hiring, it is void." It is worth noting the factual distinction between the jurisprudence cited by the Court and Mr. Rutledge's circumstances. In the cases cited by the Court, the employment contracts would have breached statutory minimums as long as the employees in question simply stayed in their current positions for longer periods of time. In Mr. Rutledge's case, a breach could only have occurred if he transferred positions within Canaan from construction work to a non-exempt position, or if Canaan expanded to a sufficient degree to enable it to meet the ESA severance pay thresholds. Neither of these changes was guaranteed, or even likely, to occur. Nevertheless, the Court maintained that "even a potential violation of the ESA, no matter how remote, should be unenforceable."

Implications for Employers

Rutledge has significant implications for employers, including employers outside of the construction industry. Following *Rutledge*, the termination provisions of any employment contract which do not contemplate severance pay because the employer's workforce or payroll are too small to meet the statutory threshold, are potentially unenforceable. More generally, employers should consider remote hypothetical fact scenarios when drafting employment contracts to increase the likelihood the termination provisions would be enforced.

The Court indicated that Mr. Rutledge's contract should have specified that the impugned elements of its termination provisions would only apply as long as Mr. Rutledge was employed in the capacity of a construction worker. Employers should ensure their employment contracts contain remedial clauses which specifically provide that in no circumstances will the employment contract purport to deny the employee their minimum statutory entitlements.

4. Manthadi v. ASCO Manufacturing ("ASCO"), 2020 ONCA 485 (July 28, 2020)

The Ontario Court of Appeal in *Manthadi* clarified the obligations owed by successor employers to long-serving employees of preceding employers in a case where a seller terminated an employee's employment in connection with an asset sale and paid termination pay in exchange for a release, before the buyer hired and then subsequently terminated the employee.

Background

Ms Manthadi was 64 years old and was employed by 63732 Ontario Limited ("637") for almost 36 years when ASCO purchased all of 637's assets. Before the transaction closed, 637 informed Ms Manthadi that ASCO would offer her continued employment. Consequently, Ms Manthadi signed a Settlement and Release Agreement with 637, which stated her employment with 637 would terminate and she would be awarded severance pay "in full satisfaction of all claims… including severance pay, termination pay or other compensation howsoever arising." Ms Manthadi received 8 weeks' severance and was subsequently employed by ASCO. However, this employment only lasted for one month before Ms Manthadi was laid off and never recalled. ASCO argued it was not a successor employer and that it only offered Ms Manthadi a short fixed-term contract to help move the purchased equipment to its new location as a general labourer and did not, as Ms Manthadi claimed, offer her indefinite employment to continue her duties as a welder.

Ms Manthadi sued for wrongful dismissal and was granted summary judgment and awarded damages (20 months' notice at common law on the basis her employment with 637 and ASCO was continuous employment pursuant to Section 9(1) of the ESA). ASCO appealed, arguing that the summary motion judge erred in considering Ms Manthadi's time at ASCO to be a continuation of her employment with 637 for purposes of calculating her entitlement to reasonable notice on termination.

Ontario Court of Appeal Decision

The Court of Appeal restated the law in Ontario applying to the notice entitlements owed to employees by successor employers, and decided a summary motion was not appropriate in this case. It set the lower court's order aside and remitted the matter for trial.

The Court of Appeal focused on the difficult position long-term employees may find themselves in when their employer sells its business. When long-term employees are terminated, they can usually expect to be paid a significant sum of damages in lieu of notice, subject to their obligation to mitigate their damages. This places long-term employees who are offered employment by the purchaser in an asset purchase transaction in a difficult position. The Court of Appeal noted that employees will be deemed to have mitigated their losses by accepting the offered employment but they will not receive damages if they accept the offers. If the offers are rejected, then the employees will not have any damages because they have failed to mitigate. The Court of Appeal further noted that, if subsequently terminated by the successor employer, the damages to be awarded to these employees will be less than the Seller would have had to pay on a termination and will probably lie in the middle ground between the ESA minimums and common law recognition of prior service with the Seller, because a court will look at an employee's past service with the seller as a factor in the reasonable notice calculation following a termination by the buyer.

The Court of Appeal concluded that the common law in Ontario remedies this difficult position by attaching value to the "experience" a long-term employee will bring to a successor employer, stating that " [a] purchaser of an ongoing business who takes on the vendor's employees avoids the burden, cost, and time of having to recruit a new employment force that is unfamiliar with the work, the working environment, and one another." In recompense for this benefit, the Court of Appeal held that courts must "appropriately weigh" the experience of a long-term employee when determining the amount of damages to be awarded to a long-term employee terminated by a successor employer following an asset purchase transaction. The Court of Appeal rejected the idea that a long-term employee's damages in lieu of notice may be assessed by simply "stitching together" the employee's service for both predecessor and successor employers. The Court of Appeal held that this approach was too rigid, and preferred the flexibility offered by requiring courts to weigh the employee's experience and the benefit of that experience to the purchaser in arriving at a fair result.

The Court of Appeal also rejected the argument that the payout Ms Manthadi received from 637 meant an award of damages made against ASCO as her successor employer constituted "double dipping". The Settlement and Release Agreement was between Ms Manthadi and 637, and did not preclude Ms Manthadi from making claims against ASCO, but should be taken into account in assessing the reasonable notice required in the circumstances.

Implications for Employers

Manthadi establishes that an employee who releases a seller from all employment-related liability in connection with the employee's employment is not precluded from making a claim against the buyer as successor employer, and is not precluded from having the employee's past service with the seller being relevant in determining the reasonable notice to be paid by the buyer as successor employer.

Manthadi also provides guidance to employers involved in asset purchase transactions regarding their obligations to long-serving employees of the seller's business, confirming that, as long as an employee's relationship with the business "continues uninterrupted despite the change in identity of their employer", their employment will be deemed continuous at common law. Ontario courts will expressly consider the value of the "experience" accrued by a long-time employee at a predecessor employer when assessing any damages owed by a successor employer. An employee's position with a former employer will only be considered in awarding common law damages to be paid by a successor employer if the employee was an indefinite employee with the former employer and became re-employed as an indefinite employee with the successor employer. The Court of Appeal stated that ASCO needed to establish unambiguously that Ms Manthadi was a fixed term employee and if it failed to do so "it [bore] the burden of displacing the presumption that Ms Manthadi's prior service with 637 should be recognized in the assessment of reasonable notice."

Ontario employers are advised to keep these considerations in mind when deciding whether, and on what terms, to offer employment to long-serving employees of a preceding employer. Employers should also be careful in making any promises of job security or indefinite employment, as well as offer letters stating the employee is expected to contribute to the company's growth and success. These statements may imply long-term employment and may be relied on by the employee in the event of an early termination and in the calculation of reasonable notice.

For further information concerning these developments, please contact any member of our **Employment Law Group**.