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JUNE 2016

The Dangers of Fixed Term Employment Contracts

Daniel M. Pugen
Partner, Employment & Labour

PHONE
416 777 5194

EMAIL
dpugen@torkinmanes.com

Daniel is a partner of the firm and a member of our Employment & Labour Group. He represents and advises management and employers on a wide variety of labour, employment and human resources/workplace issues.

The recent Ontario Court of Appeal decision of *Howard v. Benson Group Inc. (The Benson Group Inc.)* offers a good reminder to employers of the dangers of entering into fixed term employment contracts with employees. The case confirmed that absent an appropriately worded termination clause, an employer will be liable to pay the employee until the end of the contract's term. This will be the case even if the employee obtains a new job during that time period and even if the remainder of the term far exceeds the employee's common-law notice period.

The Case

The employer ran an automotive service centre and the employee was hired as "Truck Shop Manager" and then as "Sales Development Manager" for a five-year fixed term. The employee was dismissed 23 months later. The employer sought to rely on the following termination clause, which would have limited the employee to 2 weeks' notice/pay:

> Employment may be terminated at any time by the Employer and any amounts paid to the Employee shall be in accordance with the Employment Standards Act of Ontario.

The lower Court found that this termination clause was unenforceable as it was "ambiguous as to the true extent of the plaintiff's entitlement under the E.S.A" and that given the "power imbalance that exists between an employer and employee" the clause should be interpreted against the employer. The lower Court then found that a "mini trial" was in order to assess the employee's common-law notice period and his mitigation efforts. This meant that the employee's notice entitlement would be assessed by the Court and based on only 2 years' service. Any amounts ordered to be paid to the employee would then be discounted by any income earned from new employment during that notice period. Under this approach, the employee's award would have been fairly small.

The employee appealed and argued that he should simply be paid out for the remainder of the unexpired contract without any obligation to mitigate. In other words, he should receive approximately 3 years' salary ($194,283.93) without any deductions for income earned from alternative employment during that 3 year period. Notably, the employer did not appeal the finding that the termination clause was unenforceable.

The Court of Appeal agreed with the employee and framed the issue as follows:

> Whether an employee who is employed under a fixed term employment contract that does not provide for early termination without cause, is entitled to payment of the unexpired portion of the contract on early termination of the contract?

In answering the question "yes", the Court of Appeal found that if a pre-determined notice period is not specified in a fixed-term employment contract, the employee is entitled to all the wages he or she would have received to the end of the fixed term had the contract not been terminated early. The Court of Appeal found this to be fair as the employer still retains the ability to draft an enforceable early termination clause:

> If an employer does not use unequivocal, clear language and instead drafts an ambiguous or vague termination clause that is later found to be unenforceable, it cannot complain when it is held to the remaining terms of the contract

The Court of Appeal then confirmed that the employee had no obligation to mitigate. It reasoned that the parties had already agreed to a fixed period of notice (i.e. the end of the term). As a result, the parties had contracted out of the common-law approach to assessing damages which involves assessing a "reasonable" notice period, paying to the employee the amounts the employee would have earned had he/she worked the notice period, and then deducting amounts earned from new employment during that notice period.

"Take-Aways" for Employers

The Court of Appeal has confirmed that in the absence of a well-worded and enforceable termination clause a fixed term contract effectively guarantees an employee payment to the end of the term if the contract is terminated early. In the present case, that meant that the employee received 3 years' pay – a significant windfall (assuming the employee can obtain alternative employment prior to the 3 years expiring).

Employers must ensure that all fixed-term employment contracts contain enforceable termination clauses. A separate clause should deal with "for cause" terminations and "without cause" terminations. In addition, an employer can insert an obligation to mitigate into the termination clause. The Court of Appeal has confirmed, again, that termination clauses must be very carefully and precisely drafted and meet the minimum statutory requirements. Only in such a case will an employer be protected against paying an employee for the remainder of the term.

Unless an employer is prepared to obtain legal advice on fixed-term contracts, or unless an employer is prepared to only use fixed term contracts for a short duration, it may very well be safer (and less expensive in the event of termination), for employers to use indefinite term employment contracts.

If you have any questions in regards to drafting or litigating employment contracts, please contact Daniel Pugen at dpugen@torkinmanes.com