COURT OF APPEAL FOR ONTARIO

CITATION: North v. Metaswitch Networks Corporation, 2017 ONCA 790
DATE: 20171016
DOCKET: C62624

Feldman, Sharpe and Roberts JJ.A.

BETWEEN

Doug North

Applicant (Appellant)

and

Metaswitch Networks Corporation

Respondent (Respondent)

Ben Hahn, for the appellant

Tracy Kay and Carrington Hickey, for the respondent

Heard: March 27, 2017

On appeal from the judgment of Justice Meredith Donohue of the Superior Court of Justice, dated August 3, 2016.

Feldman J.A.:

[1] Doug North's employment with Metaswitch Networks Corporation was governed by a written employment contract (the "Agreement"). When North's employment was terminated without cause, a dispute arose as to whether he was entitled to be paid in accordance with the Agreement, or based on common law reasonable notice.

[2] The Agreement contained a termination clause that amounted to contracting out of an employment standard mandated by the *Employment Standards Act, 2000,* S.O. 2000, c. 41 (the "ESA"). However, the Agreement also contained a severability clause. The issue before the application judge and on this appeal is the interpretation and application of the two clauses in light of s. 5 of the ESA, which prohibits employers and employees from waiving or contracting out of any employment standard prescribed by the ESA, except to provide a greater benefit to the employee.

[3] The application judge used the severability clause to excise what she found to be the offending part of the termination clause. For the reasons that follow, I would set aside the decision of the application judge and find that North is entitled to receive termination pay based on common law pay in lieu of reasonable notice.

FACTS

[4] The appellant was employed from November 2012 to March 2016 with the respondent, pursuant to the Agreement. His earnings consisted of salary plus commission.

[5] His employment was terminated in accordance with paragraph 9(c) of the Agreement, under Termination of Employment, the relevant part of which provides:

9. Termination of Employment

> (c) Without Cause – The Company may terminate your employment at any time in its sole discretion for any reason, without cause, upon by [sic] providing you with notice and severance, if applicable, in accordance with the provisions of the Ontario *Employment Standards Act* (the "Act"). In addition, the Company will continue to pay its share all [sic] of your employee benefits, if any, and only for that period required by the Act.
>
> The reference to notice in paragraphs 9(b) and (c) can, at the Company's option, be satisfied by our provision to you of pay in lieu of such notice. The decision to provide actual notice or pay in lieu, or any combination thereof, shall be in the sole discretion of the Company. All pay in lieu of notice will be subject to all required tax withholdings and statutory deductions.
>
> In the event of the termination of your employment, any payments owing to you shall be based on your Base Salary, as defined in the Agreement.

[6] The appellant took the position that this part of the Agreement was void under s. 5(1) of the ESA, because the sentence that provides that payments are to be based "on your Base Salary" contravened the ESA by excluding his commission. Therefore, he was entitled to receive termination compensation based on common law pay in lieu of reasonable notice.

[7] The respondent's position was that if the termination clause was illegal because of the one offending sentence, then that sentence should be excised from the Agreement, using the severability clause contained in para. 17(a) which provides:

> **17. General Provisions**
>
> (a) If any part of the Agreement is found to be illegal or otherwise unenforceable by any court of competent jurisdiction, that part shall be severed from this Agreement and the rest of the Agreement's provisions shall remain in full force and effect.

[8] That would leave the balance of para. 9 in force, and the appellant would be paid termination pay calculated in accordance with the ESA.

[9] The appellant sought to have the issue of the applicability and effect of the severability clause determined by the court on an application under Rule 14 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, where the determination of rights depends on the interpretation of a contract and there are unlikely to be any material facts in dispute.

THE FINDINGS OF THE APPLICATION JUDGE

[10] The application judge accepted that the sentence in the termination clause, para. 9 of the Agreement, that reads: "[i]n the event of the termination of your employment, any payments owing to you shall be based on your Base Salary, as defined in the Agreement", had the effect of excluding payment of commission to which the appellant was entitled, and therefore contravened the ESA.

[11] "Employment standard" is defined in s. 1(1) of the ESA as "a requirement or prohibition under this Act that applies to an employer for the benefit of an employee". Sections 57, 60 and 61 set out employment standards in relation to termination of employment. Section 57 of the ESA stipulates minimum notice

periods for termination. Section 60 provides that during such a notice period, wages cannot be reduced and employees are entitled to their regular wages. Section 61 allows an employer to terminate the employment of an employee without notice, so long as the employer makes a lump sum payment equivalent to the amount that would have been received under s. 60 (i.e., based on regular wages) and continues to make benefit plan contributions. The definition of regular wages includes wages, which are defined broadly in the ESA, in s. 1(1), as:

> (a) monetary remuneration payable by an employer to an employee under the terms of an employment contract, oral or written, express or implied,
>
> (b) any payment required to be made by an employer to an employee under this Act, and
>
> (c) any allowances for room or board under an employment contract or prescribed allowances[.]

[12] The definition goes on to list certain exclusions that are not relevant in this case. Wages have been held to include commissions: see Kimberly A. Parry and David A. Ryan, *Employment Standards Handbook*, 3d ed. (Toronto: Thomson Reuters, 2017) vol. 1, at p. 1-29; and *Paquette c. Quadraspec Inc.*, 2014 ONCS 2431, 121 O.R. (3d) 765, at para. 27. By excluding commissions, the employer therefore contravened the employment standard of ss. 60 and 61. In oral argument before this court, the respondent did not dispute this illegality.

[13] The application judge addressed the severability clause and found that para. 17(a) expressed the intention of the parties that "any illegal or unenforceable parts were to be severed to allow the rest of the agreement to stand." She then recited the portion of the termination clause, para. 9(c), which states that notice and severance, if applicable, were to be provided "in accordance with the provisions of the Ontario *Employment Standards Act*". She concluded that the parties' intention was to comply with the ESA.

[14] In interpreting and giving effect to the severability clause, the application judge referred to the reasoning of Dunphy J. in *Oudin v. Centre Francophone de Toronto, Inc.*, 2015 ONSC 6494, 27 C.C.E.L. (4th) 86, aff'd 2016 ONCA 514, 34 C.C.E.L. (4th) 271, leave to appeal to SCC refused, [2016] S.C.C.A. No. 391, where, using a severability provision, he excised from a termination provision one reason among a list of reasons for dismissal without pay, stating, at para. 41, that "[t]he excision of the offending reason from the list does no violence to the integrity of the remainder of s. 4 which contains a list of other unrelated grounds for termination."

[15] The application judge found that the same reasoning would apply to the Agreement: the illegal clause limiting the pay upon termination to be based on base salary only "could be removed in its entirety pursuant to the para. 17(a) severability clause. The parties would be left with [para.] 9(c) as to what payments would be owing." She was satisfied that the term "any part" in para.

17(a) was not ambiguous and could apply to the offending sentence. She rejected the argument that the severability clause was void as a result of s. 5(1) of the ESA.

ISSUES

[16] The issues on this appeal are:

> 1) Did the application judge err in law by using the severability clause of the Agreement to save the termination clause that contravened the ESA?
>
> 2) Did the application judge err in law by failing to find that the severability clause had no application to a clause of the Agreement that was rendered void by s. 5(1) of the ESA?

ANALYSIS

(1) Did the application judge err in law by using the severability clause of the Agreement to save the termination clause that contravened the ESA?

(a) The employment law framework

[17] When deciding this case, the application judge did not have the benefit of this court's recent decision in *Wood v. Fred Deeley Imports Ltd.*, 2017 ONCA 158, 134 O.R. (3d) 481, on the issue of the interpretation and treatment of termination clauses in an employment contract. While deference is owed to the application judge on issues of contractual interpretation, no deference is owed where there is an extricable error of law: see *Wood*, at para. 43; and *Ledcor*

Construction Ltd. v. Northbridge Indemnity Insurance Co., 2016 SCC 37, [2016] 2 S.C.R. 23, at paras. 21, 36.

[18] In *Wood*, Laskin J.A. set out the principles that govern the payment owed to an Ontario employee whose employment is terminated without cause. He summarized the law as follows, beginning at paras. 15-16:

> At common law, an employee hired for an indefinite period can be dismissed without cause, but only if the employer gives the employee reasonable notice. In *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986, at p. 998, the Supreme Court characterized the common law principle of termination of employment on reasonable notice "as a presumption, rebuttable if the contract of employment clearly specifies some other period of notice".
>
> Ontario employers and employees can rebut the presumption of reasonable notice by agreeing to a different notice period. But their agreement will be enforceable only if it complies with the minimum employment standards in the ESA. If it does not do so, then the presumption is not rebutted, and the employee is entitled to reasonable notice of termination.

[19] And continuing at paras. 25-28:

> The question of the enforceability of the termination clause turns on the wording of the clause, the purpose and language of the ESA, and the jurisprudence on interpreting employment agreements. That jurisprudence is now well-established. I will summarize it briefly.
>
> In general, courts interpret employment agreements differently from other commercial agreements. They do so mainly because of the importance of employment in

a person's life. As Dickson C.J.C. said in an oft-quoted passage:

> Work is one of the most fundamental aspects in a person's life, providing the individual with a means of financial support and, as importantly, a contributory role in society. A person's employment is an essential component of his or her sense of identity, self-worth and emotional well-being.

As important as employment itself is the way a person's employment is terminated. It is on termination of employment that a person is most vulnerable and thus is most in need of protection.

The importance of employment and the vulnerability of employees when their employment is terminated give rise to a number of considerations relevant to the interpretation and enforceability of a termination clause:

- When employment agreements are made, usually employees have less bargaining power than employers. Employees rarely have enough information or leverage to bargain with employers on an equal footing.

- Many employees are likely unfamiliar with the employment standards in the ESA and the obligations the statute imposes on employers. These employees may not seek to challenge unlawful termination clauses.

- The ESA is remedial legislation, intended to protect the interests of employees. Courts should thus favour an interpretation of the ESA that "encourages employers to comply with the minimum requirements of the Act" and "extends its protections to as many employees as possible", over an interpretation that does not do so.

> - Termination clauses should be interpreted in a way that encourages employers to draft agreements that comply with the ESA. If the only consequence employers suffer for drafting a termination clause that fails to comply with the ESA is an order that they comply, then they will have little or no incentive to draft a lawful termination clause at the beginning of the employment relationship.
>
> - A termination clause will rebut the presumption of reasonable notice only if its wording is clear. Employees should know at the beginning of their employment what their entitlement will be at the end of their employment.
>
> - Faced with a termination clause that could reasonably be interpreted in more than one way, courts should prefer the interpretation that gives the greater benefit to the employee. [Citations omitted.]

[20] Section 5 of the ESA prohibits employers and employees from waiving or contracting out of any of the employment standards prescribed in the ESA, except to provide a greater benefit to the employee. Any such contracting out is void. The text of s. 5 is as follows:

> 5. (1) Subject to subsection (2), no employer or agent of an employer and no employee or agent of an employee shall contract out of or waive an employment standard and any such contracting out or waiver is void.
>
> (2) If one or more provisions in an employment contract or in another Act that directly relate to the same subject matter as an employment standard provide a greater benefit to an employee than the employment standard, the provision or provisions in the contract or Act apply and the employment standard does not apply.

[21] Most importantly, in *Wood*, at para. 21, the court explained the effect of the principles established by the Supreme Court in *Machtinger* regarding the consequences of s. 5(1) of the ESA:

> Contracting out of even one of the employment standards and not substituting a greater benefit would render the termination clause void and thus unenforceable, in which case [the employee] would be entitled to reasonable notice of termination of her employment at common law.

[22] This interpretation of the operation and effect of s. 5(1) of the ESA explains how a court is to approach the interpretation of termination clauses that waive or contract out of one employment standard, but comply with others.

(b) Application of the principles

[23] In my view, the application judge erred in her approach to the interpretation and application of the severability clause. It is convenient to restate para. 17(a) of the agreement here for ease of reference:

> **17. General Provisions**
>
> (a) If any part of the Agreement is found to be illegal or otherwise unenforceable by any court of competent jurisdiction, that part shall be severed from this Agreement and the rest of the Agreement's provisions shall remain in full force and effect.

[24] The severability clause directs that the part of the agreement that is to be severed is the part that a court would find to be illegal. The rule from *Wood*, following *Machtinger*, is that where a termination clause contracts out of one

employment standard, the court is to find the entire termination clause to be void, in accordance with s. 5(1) of the ESA. It is an error in law to merely void the offending portion and leave the rest of the termination clause to be enforced.

[25] As a result, the application judge erred in law by severing only the offending sentence that referred to using only base salary to calculate termination pay in lieu of notice, rather than the entire termination clause. Para. 17(a) requires that the part to be severed is the part that a court would find to be illegal, which must be the entire termination clause.

[26] Because of the conclusion I have reached based on the meaning and application of para. 17(a), there is no need in this case to address the Supreme Court decision in *Shafron v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6, [2009] 1 S.C.R. 157, referred to by the appellant, and to what extent the rules regarding blue pencil and notional severance may apply in the context of the severability clause drafted by the parties.

(2) Did the application judge err in law by failing to find that the severability clause had no application to a clause of the Agreement that was rendered void by s. 5(1) of the ESA?

[27] The appellant also argued, in the alternative, that the effect of s. 5(1) of the ESA is to make the severability clause void. The application judge rejected that submission.

[28] While I agree with the application judge that the severability clause is not rendered void by s. 5(1), I would frame the issue differently. The issue is not whether the severability clause is void, but whether it can have any application on the termination clause, if that clause is void as a result of s. 5(1).

(a) Consequences of a voided clause, absent a severability clause

[29] Section 5(1) prohibits contracting out of or waiving an employment standard, and provides that any such contracting out or waiver is void. An employment standard is defined in s. 1(1) as: “a requirement or prohibition under this Act that applies to an employer for the benefit of an employee”.

[30] The result is that an offending termination clause that is void has no application to oust the common law, which again applies, requiring pay in lieu of reasonable notice. As discussed above, in *Wood*, at para. 21, this court explained that where a termination clause contains “even one” instance of contracting out of an ESA employment standard, the clause is void.

[31] In *Machtinger*, Iacobucci J. gave a number of policy reasons for finding that where there is contracting out of an employment standard within a termination clause, the effect is to void the entire clause (resulting in entitlement to reasonable notice), and not just the removal of the impugned clause (resulting in entitlement to the statutory minimum termination pay provisions).

[32] He stated at p. 1003, that in light of the objective of the ESA to protect the interests of employees:

> [A]n interpretation of the [ESA] which encourages employers to comply with the minimum requirements of the [ESA], and so extends its protections to as many employees as possible, is to be favoured over one that does not.

[33] He continued at p. 1004:

> If the only sanction which employers potentially face for failure to comply with the minimum notice periods prescribed by the [ESA] is an order that they minimally comply with the [ESA], employers will have little incentive to make contracts with their employees that comply with the [ESA].

[34] And as many employees are not aware of their legal rights or will not go to the trouble or expense of trying to have the contract set aside in court, they will accept the illegality: see *Machtinger*, at p. 1004.

[35] Nor would it be a hardship for the employer to draft a contract that complies with or accounts for potential changes in the ESA. As Iacobucci J. stated, at pp. 1004-1005:

> Absent considerations of unconscionability, an employer can readily make contracts with his or her employees which referentially incorporate the minimum notice periods set out in the [ESA] or otherwise take into account later changes to the [ESA] or to the employees' notice entitlement under the [ESA].

[36] Justice Iacobucci concluded his analysis by observing, at p. 1005:

> Given that the employer has attempted, whether deliberately or not, to frustrate the intention of the legislature, it would indeed be perverse to allow the employer to avail itself of legislative provisions intended

> to protect employees, so as to deny the employees their common law right to reasonable notice.

[37] In my view, these same policy considerations should inform the approach to be taken when considering the operation of s. 5(1), where an employment contract contains a severability clause.

(b) Approaches to interpreting and applying a severability clause

[38] When a severability clause is introduced into the contract, the issue is whether: (i) the severability clause can be used to remove the illegality in the termination clause; or (ii) because the termination clause as drafted is void as a result of s. 5(1), there is nothing on which the severability clause can act.

(i) First approach

[39] In *Oudin*, the motion judge relied on the wording of the specific severability provision in the employment contract that directed modification "only to the extent necessary" to comply with the law: see *Oudin*, at paras. 35, 40. The motion judge found that this established the clear intention of the parties: see *Oudin*, at para. 42. Similarly in *Miller v. Convergys CMG Canada Limited Partnership*, 2014 BCCA 311, 16 C.C.E.L. (4th) 49, leave to appeal to SCC refused, [2014] S.C.C.A No. 424, the court stated at para. 42:

> Where the parties anticipated the possibility of severance and chose contractual language to govern this eventuality, severability is not just a remedial question. Before turning to remedy, the starting point must be to give effect to what the parties reasonably

> intended if a provision of the contract is found unenforceable by reason of illegality.

[40] The problem with this approach is that, to the extent that it effectively rewrites or reads down the offending provisions, it has the very effect referred to by Iacobucci J. in *Machtinger* – employers will be incentivized to contract out of the ESA but include a severability clause to save the offending provision in the event that an employee has the time and money to challenge the contract in court. Similar concerns were recognized by this court in *2176693 Ontario Ltd. v. Cora Franchise Group Inc.*, 2015 ONCA 152, 124 O.R. (3d) 776, where the court declined to order severance of an illegal clause in a franchise agreement because, if the only consequence to a franchisor is that the illegal clause is read down to make it legal, franchisors would be encouraged to draft illegal contracts.

(ii) Second approach

[41] The other approach is to first assess the termination clause to see whether there is any contracting out of an employment standard. If there is, then the termination clause is void, and there is nothing to which the severability clause can be applied. In that way, the severability clause is not void, but it is inoperative where the agreement contracts out of or waives an employment standard.

[42] In my view, this approach is the one that is consistent with the intent of the ESA and the Supreme Court decision in *Machtinger*. Nor does it do any injustice to the contractual interpretation principle of ascertaining the intention of the

parties. Because the termination clause is void, it cannot be used as evidence of the parties' intentions to comply with the ESA: see *Machtinger*, at p. 1001.

[43] This approach also causes no disadvantage to employers, who, as noted by Iacobucci J., are free to make a legal contract that limits an employee's rights on termination to the standards set by the ESA.

[44] As noted above, this conclusion does not make the severability clause void. It continues to have application to the rest of the agreement. However, it cannot have any effect on clauses of the contract that have been made void by statute. Those terms are null and void for all purposes and cannot be rewritten, read down or interpreted through the application of a severability clause to provide for the minimum standard imposed by the ESA.

[45] I would therefore hold that s. 5(1) of the ESA makes the severability clause, para. 17(a), inoperative on the termination clause, which contracts out of an employment standard.

[46] This result may appear to be inconsistent with this court's dismissal of the appeal in *Oudin*. The application judge found the motion judge's reasons in *Oudin* to be analogous. However, the courts in *Oudin* also did not have the benefit of this court's subsequent decision in *Wood*. Further, the issue of the applicability of the severability provision in light of s. 5(1) of the ESA was not discussed in the endorsement as the basis of the appeal. Rather, the basis of the appeal was primarily focused on the correctness of the motion judge's

determination that the termination provisions respecting notice did not offend the ESA. Therefore, this court's endorsement in *Oudin* should not be viewed as supporting a broad, overarching principle regarding the motion judge's application of the severability provision in that case: see *R. v. Timminco Limited* (2001), 54 O.R. (3d) 21 (C.A.), at para. 36; and *R. v. Singh*, 2014 ONCA 293, 120 O.R. (3d) 76, at para. 12.

RESULT

[47] I would allow the appeal with costs, set aside the decision of the application judge, and order that the appellant is entitled to receive termination pay based on common law reasonable notice. I would fix the costs of the appeal at $17,000 inclusive of HST and disbursements, and the costs of the application at $8,000 inclusive of disbursements and HST.

Released: "K.F." October 16, 2017

"K. Feldman J.A."
"I agree. Robert J. Sharpe J.A"
"I agree. L.B. Roberts J.A."