

## The effective employment contract

If you are an employer, you are in a contractual relationship with your employees. The question is, is the relationship set out in writing, or are its terms implied by the common law as developed and interpreted in our courts? While it is clear that there are benefits from "having it in writing", it is no less clear that even written contracts have to be enforced and that enforceability still ultimately rests with the courts.

Moreover, courts have often been unwilling to enforce employment contracts, based on suspicions that they are drawn up in circumstances marked by unfairness and unequal bargaining power. In showing this reluctance, courts are merely applying legal doctrine in light of what is believed to be society's vision of itself. This vision has been described by legal scholars in the following terms:

"There is a strong public interest today in ensuring that superior power wielders in all walks of life, not just employment, exercise such power in a manner that respects the personal dignity and autonomy of their subordinates. In the employment sphere, the risk of abuse by employers is especially acute because of the dominant bargaining power they have over most workers in middle to low occupational groups."

Whether or not it is justified, employers must contend with this heightened level of judicial scrutiny over the "peculiar" type of contract between employer and employee. (See ["Term contract does not a temporary employee make"](#).) However, courts will uphold the terms of a carefully crafted employment contract despite these concerns, particularly when the contract is made with senior executives who have significant bargaining power and access to legal advice. In this article, we examine the key issues to bear in mind when contemplating the use of a written employment contract.

### THE BENEFITS

Having a contract provides the parties with certainty about some key aspects of the relationship. For example, is it to last for an indefinite period of time, or for a limited term? What do the parties consider to be a reasonable notice period for termination without cause? Does the employer want the ability to alter the terms of employment in order to respond to changed business conditions, without triggering a claim of constructive dismissal? Is special protection required against harmful or unfair competition by former employees?

These are the types of issues to be considered in determining whether to use an employment contract. Generally, the more senior the prospective employee's position, the greater the level of responsibility and access to proprietary information and the more complex the compensation arrangements are. The more likely one is to choose a formal

complex the compensation arrangements are, the more likely one is to choose a formal contract.

### A VALID, ENFORCEABLE CONTRACT

Contracts, in order to be valid, must involve consideration, that is, something of value promised by each party to the bargain. In employment contracts, the consideration is the employer's promise to hire and the employee's promise to perform service. This means that, if the contract is entered into after the employee starts working, it may not be enforceable, as courts may hold that the employer's promise to *continue* to employ an employee already on the job is not legally valid consideration. As well, asking a current employee to enter into a formal contract may arouse his or her suspicions and justify a claim of constructive dismissal. Therefore, if an employer wishes to have an existing employee enter into a written contract, it is best to choose a time when it is providing additional consideration, such as a promotion or a substantial compensation increase.

Contractual provisions that breach minimum standards contained in employment standards legislation are illegal and will be struck down in court. However, even a provision that complies with minimum standards may not be spared if it is found by a court to be unreasonable. It is therefore important to demonstrate that the contract has been freely negotiated by the employee, and not dictated by the employer. To this end, the employee should be encouraged to secure independent legal advice. Remember, if the dispute ends up in court, the onus is on the employer to show that what may appear to be a harsh term was negotiated with the employee in a fair and equal manner.

### TERMINATION CLAUSE

Breach of statutory minimum standards in an employment context most often occurs with provisions that involve reasonable notice on termination. Courts have taken a tough line when this happens and have held that, where the notice provided is less than the statutory minimum, the remedy will not be substitution of the statutory notice period but rather reasonable notice under the common law, a significant gain for the employee. In other words, the remedy for an illegal clause is to strike it down entirely, rather than to use it as an indicator of what the parties had intended.

Further, a provision that was reasonable at the point of hiring may not be reasonable later on. As one legal expert has stated, "the court will not accept that the two week notice period agreed to by the vice-president fifteen years ago, when he joined the company as a sales clerk, should be adhered to". If such changes are not anticipated in the original document, they should be addressed through new contracts as appropriate.

### RESTRICTIVE COVENANTS

One important function of the employment contract is to restrict harmful or unfair conduct by a departing employee. This is achieved through the use of restrictive covenants - provisions that limit the right of former employees to compete with the employer, solicit its employees or customers, or disclose confidential business information. Again, it is crucial to craft such provisions with an eye to their enforceability in court. Sweeping, unreasonable prohibitions will be struck down, and the court will look to the common law to assess the nature of the employee's obligations.

Assessing the reasonableness of restrictive covenants is largely a matter of balancing the right of the employer to protect its business interests from harm against the right of former employees to earn a living in their chosen fields. Covenants cannot be used simply to eliminate unwanted competition. Accordingly, employers have to establish that there is a demonstrable threat that must be countered and that the covenant goes no further than necessary to protect the interest at stake. Clearly, the appropriate response will vary with the type of business involved and the specific facts of each case.

The employer must establish first that there is a legitimate proprietary interest that needs protection. With clauses that restrict solicitation of other employees, for example, it must show that there is a genuine need for this type of protection, and that they are not being used to prevent voluntary departures of employees. Where information is at issue, to warrant protection, it must be information "peculiar" to the employer, such as customer lists, trade secrets, pricing information or marketing strategies. Skill and general business knowledge obtained on the job, and information readily available outside the business are less likely to be seen as confidential information. (See also ["General knowledge acquired during employment not "confidential information", Alberta Appeal Court rules"](#), and ["Manager, employee hit with damages for "unfair" use of confidential information"](#)).

The geographic scope and duration of the restriction must also be reasonable. A geographic restriction on competition should be no greater than is required to protect the employer's interest, and probably no greater than the area of operation assigned to the former employee. With respect to duration of the restriction on competition, courts will look to factors such as the time it would take to train a new employee to replace the departing one, or the time the departing employee's influence over the employer's customers might reasonably be expected to endure following the employee's departure. Failure to specify a limitation in terms of either area or time may result in a presumption that the restriction is unlimited, and consequent nullification of the entire covenant.

A well-crafted covenant can eliminate uncertainty about the nature of the interest to be protected and the scope of protection required. This, in turn, will lessen the need to resort to costly litigation to sort these issues out. However, care must be taken in drafting the covenant to ensure that it goes no further than necessary to prevent harmful activity by former employees. (See also ["Ontario court orders consultant to pay damages to consultant placement firm for breach of confidentiality"](#) and ["Ontario Court of Appeal: restrictive covenant unenforceable"](#).)

### In Our View

Even without the contractual safeguards described in this article, under the common law, employees owe their employers a duty of confidentiality and a duty of loyalty and good faith which, in the case of senior employees, amounts to a fiduciary duty. These duties co-exist with any contractual obligations of the employee, and can be asserted in the event the contract term is unenforceable. However, while these common law obligations may give the employer the protection it requires, this will not always be the case.

For example, some confidential information which can be validly restricted under a covenant may safely be disclosed under the common law by employees following departure. Similarly, competition that may not be subject to a common law duty of loyalty following an employee's departure may reasonably be restricted by means of a properly worded non-competition clause.

For further information, please contact [Lynn Harnden](#) at (613) 563-7660, Extension 226.

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