



What's New in HR Law

Ontario Court of Appeal Considers Several Questions About Successive Employment Contracts Executed After the Sale of a Business Co-Owned by the Employee

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Bottom Line

In the recent Ontario Court of Appeal case, *Kerzner v American Iron and Metal Company Inc.*, the Court considered several questions about successive employment contracts executed after the sale of a business co-owned by the employee. These include: an employee's ability to limit termination entitlements under the common law and the *Employment Standards Act, 2000* ("ESA") as part of a sale of business, fixed-term versus indefinite contracts, non-competition clauses, and breaches of fiduciary duties.

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Facts: Employee was president and co-owner of a business which was sold through a share purchase agreement

The Employee had been hired in 1980 by a company called Bakermet Inc. (“Bakermet”). In 2008, Bakermet was acquired by another company (the “Purchaser”) pursuant to a Share Purchase Agreement (the “SPA”). At the time, the Employee was the president and co-owner of Bakermet. The SPA included a clause releasing the Purchaser from any claim in connection with the Employee’s employment with Bakermet (the “Release”).

As part of the purchase, the Employee also signed a written employment agreement (the “2008 Employment Contract”) with the Purchaser in which he agreed to work as the General Manager of the former Bakermet operations. The 2008 Employment Contract included non-competition and non-solicitation clauses.

The Employee entered into two subsequent employment contracts with the Purchaser for three- and two-year terms respectively (the “2011 Employment Contract” and the “2014 Employment Contract”).

Both the 2011 and the 2014 Employment Contracts required the Purchaser to provide the Employee with six months’ notice if the company did not intend to renew his contract. Both also contained a limitation clause that provided the Employee with six months’ pay in lieu of notice if the Employee’s employment was terminated. The 2011 and 2014 Employment Contracts also incorporated more stringent non-competition and non-solicitation clauses than existed in the 2008 Employment Contract.

In 2015, American Iron and Metal Company Inc. (“American Iron”) acquired the former Bakermet assets from the Purchaser. Several months later, American Iron dismissed the Employee with one week’s working notice. The Employee filed a wrongful dismissal claim against American Iron.

Within two months of his employment termination, the Employee purchased and became the president of one of American Iron’s competitors, Palmer Recycling Inc. This led American Iron to file counterclaims against the Employee for breach of the non-competition and non-solicitation clauses in the 2014 Employment Contract and for breach of fiduciary duty.

In a motion for summary judgment, the motion judge upheld the Release and awarded the Employee six months' salary in lieu of notice in accordance with the 2014 Employment Contract. The motion judge dismissed American Iron's counterclaims. Both parties appealed the motion court judge's decision.

The Court of Appeal's Determination

(1) The effect of the Release on the Employee's legal entitlements upon termination

In assessing what effect the Release had on the Employee's legal entitlements upon termination, the Court considered two provisions of the *ESA*:

- (i) section 5(1), which prohibits contracting out of or waiving any statutory obligations under the *ESA*; and
- (ii) section 9(1), which states that, where an employee's employment is transferred as part of a sale of business, their length of employment under the *ESA* will include their period of employment with the seller.

Relying on these two provisions, the Court held that "regardless of whether the Release is a stand-alone agreement or part of a 'package deal' [as part of a sale of business], it must comply with the *ESA*" because section 5(1) of the *ESA* prohibits contracting out of the *ESA*.

Because section 9(1) of the *ESA* requires an employee's pre-sale service to be included when calculating length of employment, the Employee's pre-2008 service could not be released for the purposes of calculating his entitlements under the *ESA*.

However, the Court accepted the motion judge's finding that the Release waived the Employee's claim to common law notice based on his pre-2008 employment.

(2) Fixed-term versus indefinite contract

The Court concluded that the Employee had been employed on an indefinite basis, rather than a fixed-term basis, even though the 2014 Employment Contract was for a two-year term.

The 2008 Employment Contract stated that it was for an "indefinite period of time unless terminated." The Court also noted that both the 2011 and 2014 Employment Contracts required

the employer to provide a fixed number of months' notice if it did *not* intend to renew the agreement, thus suggesting that his employment would otherwise continue.

The Court also took into account the Employee's pre-2008 service. It stated that, regardless of the Release, "[the Employee's] prior employment remained a fact and formed part of the context for the subsequent agreements governing his continued employment."

Based on the above factors, the Court held that the Employee was employed for an indefinite term, rather than pursuant to a fixed-term contract. Therefore the Employee's termination entitlements were not limited to those set out in the 2014 Employment Contract.

(3) The limitation clause was unenforceable

The Court determined that the limitation clause in the 2014 Employment Contract was unenforceable because the Employee's statutory entitlements, based on approximately 35 years of service, exceeded the six months provided for in the 2014 Employment Contract as well as the seven months' reasonable notice that the Employee was entitled to under the common law (based on his post-2008 period of service). As a result, the Court awarded the Employee 34 weeks' salary pursuant to his entitlements under the *ESA*.

(4) The non-competition clause

In assessing the reasonableness of the non-competition clause, the Court held that there is a "more lenient standard in the context of a sale of a business as compared to a pure employment contract."

The Employee had agreed to a non-competition clause in the 2008 Employment Contract, signed as part of the sale of Bakermet; however, American Iron alleged that the Employee had violated the more stringent non-competition included in the 2011 and 2014 Employment Contracts.

Because those contracts were signed by the Employee several years after he had sold Bakermet, and strictly in his capacity as an employee, the Court held that the reasonableness of the non-competition clause in those contracts "should be subject to the more onerous employer/employee test."

The Court held that the non-competition clause was not enforceable. The Court stated that the non-competition clause in the 2014 Employment Contract was geographically unreasonable

based on the Employee's age, the fact that he had only ever worked in the same industry, and because it covered territories in which the Employee did not do any business when he signed the 2014 Employment Contract.

(5) The non-solicitation clause

The Court also dismissed American Iron's counterclaim that the Employee had violated the non-solicitation clause in the 2014 Employment Contract. The Court held that the Employee had not violated the non-solicitation clause by purchasing and serving as the president of Palmer Recycling Inc. because he had not contacted any of American Iron's clients.

(6) Breach of fiduciary duty

Finally, the Court dismissed American Iron's counterclaim that the Employee had breached his fiduciary duties to the company for lack of evidence.

Check the Box

In light of this decision, employers should consider the following when drafting and preparing employment contracts for executives and other employees whose employment is transferred as part of a sale of business:

- The employee's years of employment *prior to* the sale of business will be considered when calculating the employee's entitlements under the *ESA*, even if the employee was also an owner of the purchased business and waived any claims relating to his/her employment with the purchased company;
- An otherwise enforceable release may not prevent a court from taking into account the employee's pre-sale employment for the purposes of determining whether a subsequent employment contract is for an indefinite or fixed term;
- When drafting a fixed-term contract, employers should have clear early termination clauses and should avoid language that states that notice must be given if the employer does not intend to renew the contract;
- Where an owner sells his/her business and becomes employed by the purchaser, courts will be more likely to enforce a contract's non-competition clause when it was agreed to by the former owner *as part of* the sale of the business rather than several years after their employment has already been transferred to the purchaser; and

- Drafting a non-competition clause to include geographic areas that an employee was not performing work in at the time that the contract was signed may result in a court finding the non-competition clause to be unenforceable.

Forum: Ontario Court of Appeal

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Need more information?

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