When Is a Severance Agreement Release Unenforceable?



Beware of “unconscionability” when getting a terminated employee’s agreement not to sue.

Because the price of termination in Canada is so high, employers typically enter into severance negotiations with employees they want to terminate. In return for a severance package, the employee typically sign a severance agreement that includes a release promising not to sue the employer. The release is supposed to settle all the claims and ensure everlasting peace between the two sides. But things don’t always go according to plan. Sometimes, employees have second thoughts about the deal they made and sue anyway. Of course, employees can only bring such a lawsuit if they can persuade the court that the release they signed was invalid. One way to attack the release is to claim that it was unconscionable—that is, so grossly unfair that no reasonable or informed person would have agreed to it and that the employer took advantage of the employee in forcing or tricking them into signing it. What makes a severance package (or an employer’s negotiating tactics) unconscionable? Take a look at the following 2 cases for guidance.

Severance Release Is Unconscionable

Situation

An assistant store manager is fired after almost 20 years on the job. The termination letter promises her a lump sum “severance” of $6,000—equal to 6 weeks’ notice—as well as employment benefits and help in finding a new job, provided that she sign a release. The manager signs the release without showing it to a lawyer. Later, she sues the employer for wrongful dismissal. The employer asks the court to enforce the release and dismiss the case without a trial.

Ruling

The Newfoundland Supreme Court rules that the release is unconscionable and, that the manager can still sue for wrongful dismissal.

Explanation

In ruling that the release was unconscionable, the court cites 3 factors:

- The inequality of bargaining position between the sides. The manager was 59, unsophisticated (with only a 10th grade education), financially vulnerable and very upset about losing her job.
- The employer took unfair advantage of its power over the manager to pressure her into signing the agreement. The court noted that the manager felt like she had no choice but to sign the release.
- The terms of the agreement were unfair to the manager. If she hadn't signed the release, she would have been entitled to between 12 and 18 months' notice.

Howell v. Reitmans (Canada) Ltd., [2002] N.J. No. 194

Severance Release Is Not Unconscionable

Situation

A lawyer, who had served as in-house corporate counsel of a TV station distribution company on 2 previous occasions gets terminated 18 months into his third stint with the company due to downsizing. The company offers him a settlement package including 3 months' notice if he signs a release. The lawyer accepts and signs the release on the spot. Then he takes a new job for less pay and, shortly thereafter, sues the employer for wrongful dismissal. He claims that the settlement and release were "unconscionable."

Ruling

The Ontario Court of Appeal rules that the settlement and release are legally valid and dismisses the case.

Explanation

The Court cites the same basic factors as the court in the *Howell* case. But this time those factors work in the employer's favor:

- Although employers are generally in a stronger bargaining position in severance negotiations with employees, unconscionability applies only when there's an "overwhelming imbalance in bargaining power caused by the victim's ignorance of business, illiteracy, ignorance of the language of the bargain . . . or a disability." The lawyer in this case was under stress—his father had died and he was up to his eyeballs in debt. But he was also a "senior lawyer with extensive experience in contract and employment law."
- The employer didn't take unfair advantage of the lawyer. He was well aware of his options and chose "with his eyes open," the Court said.
- The terms of the severance agreement, including the 3 months' notice that the lawyer accepted weren't "grossly unfair."

Titus v. William F. Cooke Enterprises Inc., 2007 ONCA 573 (CanLII)