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Buying or Selling a Business in Ontario?
Don't Forget About the Employees

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During any business acquisition, lawyers routinely advise clients on the relevant legal, tax, and business considerations. However, too often this advice excludes timely, comprehensive thought about the employees affected by the transaction. This oversight can be costly.

Early in any negotiation, vendors and purchasers need to be aware of the costs of employee entitlements and which party will be responsible for those costs. Such costs may include termination pay and severance. However, calculating these costs and how they may be borne by the vendor or purchaser can depend on complicated interactions between statute, contract, and common law. In addition, there are other liabilities that may be more costly to the transaction—or even fatal—such as whether key employees are bound by enforceable non-solicitation and non-competition clauses. No one wants to buy a business (or sell one subject to a large performance-related holdback) only to have all the key employees quit, solicit the business' customers, and start a competing business.

In this series, we will review critical considerations and employment law related risks and liabilities that arise in the context of buying or selling a business. Part 1 of this series focuses on asset transactions.

Part 1: Asset Transactions

In an asset sale, a purchaser is purchasing assets of the vendor company as well as (in most cases) various liabilities. The vendor company remains responsible for liabilities not assumed under the asset purchase agreement.

In a share transaction, the purchaser is purchasing the *shares* of the vendor company. It is a transfer of ownership of the business, but not the corporate identity. This article will focus only on asset sales.

In an asset sale, if a set of assets constitutes a "going concern" and the vendor transfers such assets to the purchaser, for those employees who accept employment with the purchaser, the employer's identity changes from the vendor to the purchaser. By contrast,

in a share purchase, ownership of the business transfers, but the corporate identity, and the employer, stays the same.

In employment law, this change in the employer's identity is key. The question of which party is responsible for employee liabilities ultimately revolves around who bears responsibility for the vendor's former employees.

Terminations, Offers of Re-Employment, and Potential Liabilities

Employment contracts cannot unilaterally be assigned to a new employer. A vendor cannot simply order its employees to keep working for the purchaser.

Accordingly, it is imperative that a vendor and a purchaser clearly set out their obligations and expectations pertaining to employees as part of any asset transaction.

For employees, there are two general outcomes in the context of an asset transaction:

(1) The vendor terminates the employment of any employees who are not being hired by the purchaser or who refuse an offer of employment from the purchaser; or

(2) The purchaser makes an offer to employ certain employees of the vendor and the employee accepts the offer.

The central question in determining employee liabilities under either outcome above, is whether the purchaser is obligated to make offers of employment to employees and on what terms.

Vendors will generally want the purchaser to hire all its employees and assume the associated liabilities. Purchasers will generally want the vendor to pay severance, wipe all liabilities off the books, and limit the future entitlements of any employees that they rehire (to the extent possible).

Note that where an employee accepts an offer of continued employment, the common law, and the *Employment Standards Act, 2000* ("**ESA**") deem the purchaser the "successor" employer, and expressly recognizes that, among other things, the purchaser is inheriting that employee's length or period of employment with the vendor for the purpose of calculations under the ESA. A successor employer effectively assumes these liabilities from the vendor. While properly crafted employment offers can waive the common law entitlements—or place those liabilities with the vendor—the ESA entitlements are obligatory.

Fundamental to any analysis in employee liability, is the fact that employees are free to decide whether to accept an offer of employment with the purchaser.

The choice of the employee is crucial, because under the common law, the vendor is deemed to have effectively terminated an employee's employment upon completion of the

transaction (assuming the vendor does not remain a going concern). If the purchaser makes an offer of employment to that vendor employee, it gives the employee an opportunity to mitigate his or her damages.
Further, the ESA notes that in most cases where there is an asset transaction, if employment continues with the purchaser, there is not deemed to be termination of employment and the employment is considered 'continuous'.

Accordingly, if the purchaser offers substantially similar employment terms to an employee of the vendor, that employee will have little recourse for any termination pay above the minimum amounts prescribed under the ESA or set out in his or her employment contract.

However, if the offer of employment by the purchaser is on substantially different terms, an employee could refuse to accept such employment and potentially be entitled to receive notice under the common law (to the extent this option is not limited by contract).

As employment liabilities can be costly, the vendor and purchaser should openly negotiate how such liabilities will be apportioned. It is essential to settle these matters early in the negotiation process—preferably when the parties are negotiating the letter of intent ("**LOI**"). Although the terms of a LOI can change in later phases of the purchase and sale, it will be hard to insert such costly terms at the end of the negotiation.

Before addressing how employment liabilities may be dealt with, there are a few key considerations to note:

(i) *Going Concern:* Not every sale of assets is a sale of a 'business' meeting the threshold of a "going concern". In such cases, where the sale of assets comprises only a part of a vendor company, the purchaser may not be inheriting the prior service of any vendor employees. Both the purchaser and the vendor need to properly understand if the sale of assets meets this threshold, as it can greatly impact the appropriate apportionment of liabilities for employees whose employment is being transferred.

(ii) *Human Rights Code:* A purchaser should be careful if it chooses to hire some employees and not others, to ensure it does not choose not to hire someone for reasons contrary to Ontario human rights legislation. Choosing not to hire someone due to a disability or another prohibited ground (such as age) may give rise to a human rights claim by an employee.

For those interested, the appendix below provides more detailed explanations for some of the key liabilities that may arise in the above negotiations.

How the Parties may Address Employee Liabilities

To fully address the employment liabilities cautioned above, the information underpinning them should be acquired as early as the due diligence stage. This disclosure permits the parties to negotiate how they will share the costs.

Step 1

Understand the extent and scope of the key liabilities:

1. How many employees are there?
2. What is their age, their position, and the nature of their role?
3. How many years of service do they have?
4. Do they have enforceable employment contracts?
5. What are the terms of their employment, whether in their contracts or at common law?
6. What are their estimated severance entitlements at common law, under their contracts, and per the relevant legislation?
7. Are there any "key" employees whose skills or knowledge are essential to the business being bought?
8. Have those key employees been made aware of the transaction, and are they interested in continuing with the new employer? If so, under what conditions?
9. Are the key employees subject to enforceable non-solicitation or non-competition agreements? If not, will losing them undermine the value of the transaction?

Step 2

Once the scope of liabilities is determined, the parties need to work cooperatively to determine which employees will or will not receive an offer of continued employment from the purchaser?

Terminating Employees Without Offering Them Continued employment

For employees that will not receive offers of continued employment from the purchaser, the parties need to arrange for their termination and appropriate notice and/or termination payment. In these cases, key considerations include:

1. Whether the employees will receive working notice of the termination or pay-in-lieu of working notice. The length of the notice and the amount of pay-in-lieu largely depend on the terms of an employee's written contract, and the employees age, seniority, nature of their role and the availability of alternative comparable employment. In some cases, if an older employee has substantial tenure and no employment contract limiting their common law rights, that employee could be entitled to up to 24 months of notice or pay-in-lieu.

2. How to minimize the negative impacts of a mass termination. Mass terminations can be a blow to morale for the employees who are staying on. They can also impact goodwill. In these situations, employers should consider carefully how the terminations will be communicated. For example, key employees who are not being terminated should be reassured that their positions are secured.

3. Whether any of the employees are receiving accommodations under human rights legislation or are otherwise on a protected leave of absence from their work (e.g., medical leave or parental leave). In some cases, the termination of these employees could lead to additional claims under human rights legislation.

Terminating an Employee and Offering Them Continued Employment

When a purchaser decides to re-hire one of the vendor's employees, the key consideration is whether they will do so on the same fundamental terms of employment. In some cases, the existing terms may be adequate, and no action will be needed. But in most cases, the purchaser will want new terms of employment. For example, by changing the location of work, limiting entitlement to notice of termination, or imposing more useful non-solicitation and non-competition clauses.

In many cases, an employee will accept the changes to the employment contract but may have concerns with the new terms at a later date, particularly if his or her employment is subsequently terminated.

An argument that such an employee may make is that they received no fresh consideration for signing a new employment agreement with the purchaser and therefore, the agreement is not enforceable.

Thankfully for purchasers, recent cases in Ontario have determined that a purchaser's offer of new employment to the employee is sufficient consideration for an agreement to be enforceable. Still, as added precautions and ways to manage risk, the following are some options a purchaser may consider when hiring employees of the vendor:

Signing Bonus: A signing bonus will be a new benefit that secures the new terms. A signing bonus also has the added value of enticing the employee to accept employment. A purchaser might consider this to entice key employees, if required.

Notice of the Change: The purchaser may negotiate with the vendor to give the employee notice of the transaction and thus the change of terms, such that they are effectively being given working notice of their termination. This satisfies the duty to provide notice. While this approach costs less in the short term, it may be less desirable, as it requires determining the appropriate notice period, having enough time before the transaction to give such notice, and may cause friction in the workplace.

Negotiate an Assessment Period: During this period, the purchaser will assess the employee's suitability for the role. If the purchaser decides not to employ the person, they would then be liable for such things as severance and termination pay. The parties may negotiate holdbacks or other terms to account for these risks.

Conclusion

Ending an employment relationship can be costly for any employer. In asset sales, these costs and resulting liabilities may multiply, such that it can be fatal to forget the employees. Both the vendor and the purchaser should address these risks as early as possible. Engaging corporate and employment lawyers during the due diligence stage is crucial to mitigate these risks by ensuring the agreement fully addresses them.

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APPENDIX

KEY LIABILITIES IN AN ASSET SALE

1. **Termination Notice and Severance.** In Ontario, employees have a right to notice of termination and, if applicable, severance pay, under the ESA. With no contract stating otherwise, employees are also entitled to reasonable notice of termination at common law, based on age, length of service, seniority of the position, and the availability of comparable employment.

2. **Statutory Entitlements.** Under Ontario's employment statutes, employees are entitled to various benefits, including vacation pay and job-protected leaves. An employee who continues their employment with a successor employer can expect to receive these entitlements. This means vacation pay and time will depend on the employee's tenure with the vendor. It also means any employee on leave at the time of the transaction can expect to return to the position they had at the time of their leave, or a comparable one. Similar considerations will apply for those on leaves related to a protected ground under the Human Rights Code ("**Code**"), such as a disability or family status.

3. **Statutory Obligations and Violations.** Ontario has several statutes that create obligations and liabilities for employers if breached. These include the ESA, the Code, the Pay Equity Act, the Workplace Safety and Insurance Act, 1997, the Occupational Health and Safety Act ("**OHSA**"), and the Pension Benefits Act. Obligations under these statutes include the need to establish committees, accommodation plans, and workplace policies. Violations could lead to orders against the employer, which may continue against the purchaser. And many of these can, in turn, create personal liability for directors and officers for employment-related debts and judgments. Purchasers want to ensure that any policies and procedures its adopting from a vendor comply with Ontario law.

4. **"Key" Employees.** These employees are part of the "know-how" of the business. They understand how it operates, represent the company's goodwill, or control the books of business that make the operation possible. Purchasers should be especially cautious of key employees. For example, suppose the key employees do not accept new employment and work for a competitor. This can damage the purchaser by devaluing the business.

5. **Employment Contracts.** On top of various statutory or common law entitlements, each employee's contract may contain different rights and obligations unique to that employee. For many purchasers, employee contracts will have terms affecting the most critical aspects of the existing employment liabilities. They may modify obligations around confidentiality, intellectual property, non-solicitation, and non-competition. They are therefore vital to review for any employee, but especially key employees. Contracts may also contain terms modifying common law entitlements such as reasonable notice or compensation rights to bonuses and shares.