# BUYING AND SELLING A BUSINESS:
# A COMPREHENSIVE GUIDE

## EMPLOYMENT CONSIDERATIONS IN THE SALE OF A BUSINESS

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The respective liabilities of vendor and purchaser for employee entitlements upon termination can become a major issue in negotiating the sale of a business. This paper will discuss employment law considerations in the sale of a business in both the statutory and common law contexts in Ontario.

## I. EMPLOYER LIABILITIES UPON TERMINATION

Before exploring the employment implications of selling a business, it is helpful to understand an employer's obligations under statute and common law upon terminating an employee.

The *Employment Standards Act, 2000* (*ESA*) is the governing legislation that sets out minimum termination and other entitlements for employees in all provincially regulated industries.[1] It contains statutory minimums for employers' liabilities to employees upon termination with and without cause. Part XV, sections 54 to 58 and 61 of the *ESA* govern statutory notice, or pay in lieu of notice of termination, which must be provided to employees with more than three months' service who have been terminated without cause, as defined in the legislation. It is based upon completed years of service, ordinarily up to a maximum of 8 weeks. If the employer terminates the employment of 50 or more employees at the employer's establishment in the same four-week period, the entitlements increase, ranging from 8 to 16 weeks, depending upon how many employees are terminated.

Section 64 governs statutory severance pay, which is payable only to an employee severed without cause, as defined, who has five or more years' service and is either employed by an

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[1] *Employment Standards Act*, 2000, S.O. 2000, c. 41; The *Canada Labour Code* has roughly equivalent provisions for federally regulated undertakings.

employer which has a payroll of $2.5 million or more or where there is a permanent discontinuance of all or part of the employer's business at an establishment which results in 50 or more employees having their employment terminated within a six month period. Statutory severance pay is equal to one week per completed and partial year of service, up to a maximum of 26 weeks.

The relationship between unionized employees and employers is also governed by the *ESA*, in addition to their collective agreements and the Ontario *Labour Relations Act, 1995* ("*OLRA*").[2] However, unionized employees can only be terminated for just cause in accordance with the provisions of the collective agreement.

The entitlement to reasonable notice of termination at common law is virtually always greater, and often significantly greater, than an employee's minimum entitlement under the *ESA*. The amount of reasonable notice depends on a number of considerations, referred to as the *Bardal* factors, which for the most part are the employee's age, length of service, compensation, character of employment, and the availability of similar employment given the employee's experience, training and qualifications.[3]

## II. MANNER OF SALE

### A. SHARE TRANSACTION:

There is no termination of employment upon the sale of shares of a company. As the identity of a corporation does not change with the sale of shares, the rights and obligations of a corporation with respect to its employees and any trade union are not modified by a change in

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[2] *Labour Relations Act*, 1995, SO1995, c 1, Sch A.
[3] *Bardal v. Globe & Mail Ltd*., 1960 CanLII 294 (ONSC).

share ownership unless either party intentionally and specifically addresses such issues.[4] If a purchaser does not wish to take on the employees of the vendor in a share sale, it must ensure that the vendor is contractually obliged to terminate the employment of those employees prior to the sale.

If a collective agreement exists, the purchaser may not wish to complete the transaction without certain amendments. As a practical matter, the purchaser in a share purchase transaction should have the vendor try to negotiate the changes to the collective agreement that the purchaser desires, as the vendor is likely in a more advantageous position to negotiate with the union. The union has no legal obligation to negotiate with the intended purchaser prior to the sale, notwithstanding that the purchaser will automatically take on the vendor's obligations in respect of the employees under the collective agreement.

## B. ASSET TRANSACTION:

In comparison to a share purchase, the sale of some or all assets of a business is likely to attract more scrutiny at law as the nature of the sale affects employees' rights upon termination.

### (i) Employment Implications Under The Common Law

At common law, the business must be sold as a "going concern" in order for employees to benefit from an implied term that the purchaser will recognize their past service with the vendor (see section (c) below). The going concern test also applies in the unionized Ontario Labour Relations Board context, but does not apply in respect of the *ESA*.[5]

The analysis begins with the traditional common law principle from *Nokes v. Doncaster Amalgamated Collieries Ltd.* that a contract of employment cannot be assigned by one

[4] *Whittemore v. Open Text Corporation*, 2013 ONSC 2339 at para 22-23.
[5] See e.g. *Federated Building Maintenance Co., Re*, [1989] O.E.S.A.D. No. 14 (Ont. E.S.B. (Adjud.)

employer to another.[6] The principle is rooted in a desire to avoid any hint of slavery and protect employees' freedom of choice. This choice does however come with consequences; the principle in *Nokes* dictates that upon the sale of a business, where the employment of the employee is not continued with the vendor, the contract of employment with the vendor must be terminated and an employee who chooses to enter into a new contract with the purchaser forfeits recognition of his or her tenure and seniority with the previous employer. On the other hand, an employee who declines a comparable offer from the purchaser is deemed at common law to have failed to mitigate his or her damages, negating a claim for wrongful dismissal.[7] Courts have attempted to temper this harsh reality with a variety of exceptions.

### (a) *Express Recognition of Past Service*

Where a purchaser expressly recognizes past service in its new employment contract with the employee, no issue arises. An employer may make the choice to recognize past service in consideration for the valuable skills and experience it is receiving with a long-service employee.

In the case of such an explicit recognition by the purchaser, the vendor would normally have no further liability at common law. However, in situations where the purchaser becomes insolvent after the purchase or for any other reason is unable or unwilling to continue to employ the employee, that employee may still be able to pursue the vendor for wrongful dismissal, depending upon how long he or she was employed by the purchaser. Specifically where the employee is unable to completely mitigate his or her common law damages through employment with the purchaser because the purchaser is no longer in operation or no longer elects to continue the employment, the employee's claim for damages against the vendor survives. The vendor would then be liable for the unmitigated portion of the employee's losses,

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[6] *Nokes v. Doncaster Amalgamated Collieries Ltd*., [1940] C 1014.
[7] *Addison v. M Loeb Ltd.,* (1986), 53 O.R. 602 at p. 604 (CA) [*Addison*].

unless the vendor can establish that there was novation of the contract between the purchaser and the employee.

Novation is described as “a trilateral agreement by which an existing contract is extinguished and a new one brought into being in its place”. Assent to the discharge of the old obligations and substitution of the new obligations by the employee, the old employer and the new employer is essential.[8] Thus there must be evidence that the employee elected to let the vendor "off the hook" upon the closing of the transaction, which in the face of an employee's claim for damages, will only be satisfied with clear and cogent evidence.

**(b)** ***Implied Recognition of Past Service***

Contrary to the traditional common law principle based upon *Nokes,* courts now generally presume that an employee will be credited for service with his or her former employer for the purpose of calculating reasonable notice of termination, unless the new employer notifies the employee to the contrary. This was first recognized by the Ontario Court of Appeal in *Addison v. Leob.*[9] In *Addison,* the purchaser treated the employee as if he had 20 years' service, and not just the 18 months' service he had with the purchaser alone, for the purposes of wage increases and employee records. The Court found it would have been unfair to treat the employee as a short-service employee for the purposes of common law notice.

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[8] *Major v. Philips Electronics Ltd.,* 2005 BCCA 170 at para 10; Novation requires 1. The new debtor (employer) must assume the complete liability; 2. The creditor (employee) must accept the new debtor (employer) as principal debtor and not merely as an agent or guarantor; and 3. The creditor (employee) must accept the new contract in full satisfaction and substitution for the old contract.

[9] *Sorel v. Tomenson Saunders Whitehead Ltd*., 1987 CanLII 154 (BC CA), [1987] 15 B.C.L.R. (2d) 38 (C.A.).)[*Sorel*]; *Addison, supra* note 7.

In *Sorel v. Tomenson Saunders Whitehead,* the British Columbia Court of Appeal came to the same result by implying a term of continued service into the employment contract based on the parties' pattern of conduct. The principle stands undisturbed.[10]

This implied term of continued service applies where a purchaser acquires a business as a "going concern"; described by the Court of Appeal in *Abbott v. Bombardier* as "the transfer of a functional economic vehicle, the activities of which could be carried on without interruption".[11]

Where the transaction is not an obvious "going concern", the implied term of continuous employment may not apply. In *Carpenter v. Brains II Canada, Inc*., the employee had 11 years' service with a company that encountered financial difficulties and was subject to creditor protection proceedings. The employment of all of the employees was terminated, with Court approval. A further Court order authorized the sale of one division of the company to the Defendant, and the Defendant went on to hire the Plaintiff in a capacity similar to her previous position, in the same location, earning the same salary. In the result, the Divisional Court declined to disturb the lower Court's decision to consider only her period of service with the Defendant and not her past service, stating:

> Here, however, this was not a simple asset sale and a mere change of ownership. There was a bankruptcy, a termination of employment, a purchase of some of the assets of the former employer and a new employment where the employee was told that the new employer would not be honouring her prior severance entitlements.[12]

Similarly, in *Hall v. Quicksilver Resources Canada Inc.*, a pulp mill ceased operations and was decommissioned for a number of months before it was purchased by a new company. The new company offered employment to the Plaintiff, who was an employee of the former owner of the

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[10] See e.g., *Kennett v. Superior Millwork Ltd*., 2003 ABQB 650, aff'd 2005 ABCA 84; *Kamen v. Rose*, 2003 CanLII 26816 (Div Ct); *Sorel, supra* note 9.
[11] *Abbott v. Bombardier Inc*., 2007 ONCA 233, 2007 CarswellOnt 1815 at para 13 [*Abbott v. Bombardier*].
[12] *Carpenter v. Brains II Canada, Inc*, 2016 ONSC 3614 (Div Ct) at paras 14-15.

mill. The BC Court of Appeal found that the business was not sold as a going concern, and moreover, the employee was provided with what was effectively a generous severance payment when the mill ceased operations.[13]

### (c) *Avoiding Vendor Liability at Common Law*

An examination of the jurisprudence, including the case law hereinbefore mentioned, supports the contention that at common law, a purchaser can avoid liability for the employees' prior service by requiring the vendor to provide common law reasonable notice of termination or pay in lieu thereof before the purchaser hires the employees. As discussed in more detail below, a vendor providing only *ESA* minimum termination entitlements upon termination will not be sufficient to cloak the vendor with protection in such circumstances. Therefore, a purchaser wishing to try to insulate itself from employee termination liabilities should include a provision in the purchase and sale agreement requiring the vendor to provide reasonable notice of termination at common law, as well as require the vendor to indemnify it for any future termination payments for those employees, or at least for that portion of future termination payments attributable to the employees' pre-sale service. Of course, if the purchaser declines to offer employment to the employees of the vendor, the vendor remains liable to the employees for common law reasonable notice.

Alternatively, the purchaser can expressly inform the employee in an employment offer, e.g., in a written contract of employment, that it will not recognize any previous service with the vendor.[14] However, in light of a recent decision in *Krishnamoorthy v. Olympus Canada Inc.*[15], if taking this approach, the purchaser is recommended to provide the employee with adequate consideration for the new contract of employment which is more than simply the offer of

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[13] *Hall v. Quicksilver Resources Canada Inc*., 2015 BCCA 291 at paras 33-34.
[14] *Sorel*, *supra* note 9.
[15] *Krishnamoorthy v. Olympus Canada Inc.,* 2016 CarswellOnt 18204, 2016 ONSC 5338

employment itself. In that case, the employee had worked with the vendor for five years prior to a 2005 asset sale to a different entity. In his new employment contract with the purchaser, Krishnamoorthy agreed to accept the greater of his *ESA* termination entitlement or 4 weeks' notice per year, to a maximum of 10 months' notice upon termination. Although some employees were provided a signing bonus in exchange for accepting new employment with the purchaser, Krishnamoorthy was not. At the time of his termination without cause by the purchaser in 2015, the Court found that as he had received no consideration, his new contract and its termination provision was unenforceable. The employee was awarded 19 months' notice in recognition of his long service. This result is somewhat inconsistent with previous case law which has held that a fresh offer of employment by a purchaser is sufficient consideration for a new contract. The employer is appealing the Court's decision.

### (ii) Employment Implications Under The *ESA*

The *ESA* effectively reverses the traditional presumption at common law that an asset sale results in a termination and that prior service will not be recognized by the new employer. Section 9 of the *ESA* ensures that the subsequent employment of an employee with the purchaser through the sale of all or part of a business is treated as continuous employment for the purposes of statutory notice of termination, severance, vacation pay, vacation time and various leaves, including pregnancy and parental leave, for which length of employment is relevant. The *ESA*'s protection of continuous employment does not apply to the common law entitlements discussed above.[16]

Section 9(1) of the *ESA* states:

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[16] Although commentators have argued that perhaps it should - see e.g. Edward Mazey, "No more Nokes in Ontario: Employment continuity after the sale of a business – An argument of statutory interpretation" (2008) 34 *Advoc Q* 52.

> If an employer sells a business or a part of a business and the purchaser employs an employee of the seller, the employment of the employee shall be deemed not to have been terminated or severed for the purposes of this Act and his or her employment with the seller shall be deemed to have been employment with the purchaser for the purpose of any subsequent calculation of the employee's length or period of employment.

Section 9(2) creates an exception where a purchaser hires an employee of the vendor more than 13 weeks after the earlier of the date of the sale and the last day of the employee's employment with the vendor.

Selling a business or part of a business is defined by section 9(3) to include leasing, transferring or disposing of in any other manner. It can include the transfer of only some assets and even the transfer of a lease of the business's premises.[17]

### (a) *Going Concern Test Not Applicable in ESA Context*

In *Abbot v. Bombardier*[18], the Court of Appeal explored the application of section 9. The claim arose from a transaction in which certain computer assets were transferred from Bombardier to a company called CGI. CGI was to assume responsibility for the delivery of IT services to Bombardier. CGI offered employment to 194 of Bombardier's employees who were considered essential to the outsourcing transaction. The parties explicitly agreed that the employees' prior service with Bombardier would be recognized if CGI was to later terminate them.

The case is unusual in that it was the employees who sought a narrow interpretation of section 9 that would require Bombardier to pay *ESA* statutory termination and severance pay at the time of the sale, rather than treat their employment as continuous such that the payments would be due upon any future termination by CGI.

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[17] See e.g. *Revin v. Lamantia Garcia Products Ltd*., 2008 CanLII 790 (ON LRB).
[18] *Abbott v. Bombardier, supra* note 11

In rejecting the employees' claim, the Court of Appeal upheld the Ontario Superior Court of Justice's view that the "going concern" test does not apply in the *ESA* context. The test had its roots in the *OLRA*, which does not define "business". To apply it in the *ESA* context would unnecessarily narrow the ambit of section 9. The Court stated:

> [T]he OLRA regime is aimed, at least in part, at providing for the continuity of relationships between unions and employers in the context of the sale of a business. By way of contrast, the purpose of the ESA regime is to protect individual rights and to preserve continuity of seniority. Viewed in this context, in our view, the meaning of business in s. 9 of the ESA is to be given an expansive interpretation.[19]

Although the employees argued that the nature of their employment had changed such that there was no continuity, the Court found that the evidence failed to demonstrate changes that rose to the level of a "fundamental or radical difference". The Court declined to decide whether such a qualification could even be read into section 9.[20]

*Abbot v. Bombardier* should not be taken to mean that outsourcing always constitutes a sale of a business. This particular outsourcing transaction involved the transfer of a specified group of employees who continued to apply essentially the same skills using the same facilities and equipment. There was also an obligation in the transaction agreement on the part of the purchaser to make offers of employment to affected employees, and the future employment of the employees was provided for in the agreement.

### (b) *Avoiding Application of the ESA to a Purchaser*

As *Abbott v. Bombardier* indicates, the application of section 9 is difficult to avoid for a purchaser, which is the party to whom the provision is intended to apply. Being remedial

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[19] *Abbot v Bombardier*, *supra* note 11 at para 20.
[20] *Abbot v Bombardier, supra* note 11 at para 25.

legislation, the *ESA* is given a broad and liberal interpretation.[21] It applies even if a business is sold between Canadian jurisdictions, and often if the business is sold through a trustee in bankruptcy.

It has been generally understood, on the basis of the Divisional Court's decision in *Ontario (Employment Standards Officer) v. Equitable Management Ltd.*, that the effect of section 9 cannot be avoided by terminating employees prior to the date of the sale.[22] This aligns with the rule, set out in section 5, that there can be no contracting out of the *ESA*. However, the effect of section 9 does appear to be somewhat inconsistent with its plain language. Section 9(1) specifically refers to the hiring of an *employee* of the vendor. If a valid termination occurs prior to hiring by the purchaser, with *ESA* statutory termination and severance pay being satisfied by the vendor, the employee is no longer an employee of the vendor at the time of hiring by the purchaser. There is some authority from Employment Standards Branch referees to support this view, which can be distinguished from *Equitable Management* on the basis that, in that case, no *ESA* statutory termination or severance pay was provided by the vendor such that there was no valid termination of the employees prior to that sale.

In *Debiasi Tool and Machine Ltd*., the referee avoided the "blind application of the statute" by taking into account the prior payment of severance and termination pay by the former employer, and decided the purchaser need not be responsible for later termination entitlements.[23] This is in line with the minority view in *Equitable Management* which left the door open to a different result where there is an actual discontinuity of employment of the employee. However, a contrasting view is apparent in more recent cases, such as *Jegasothy v. The Label Depot Inc.,*

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[21] *Abbott v. Bombardier*, supra note 11 at para 17.
[22] *Ontario (Employment Standards Officer) v. Equitable Management Ltd.,* 1990 CarswellOnt 785, [1990] O.J. No. 1746 (Div Ct) at para 16-17 [*Equitable Management*].
[23] *Debiasi Tool and Machine Ltd,* [1991] O.E.S.A.D. No. 106 Decision No. 2928; Some older cases, such as *Rene Sauve Ltd*, ESC 1207 (April 15, 1982) and *539747 Ontario Ltd*., ESC 2185 (October 14, 2986) follow the same reasoning, but there is a dearth of more recent cases taking this position.

in which the Labour Board points out that if it had been intended that a prior payment of termination pay ought to be deducted from the successor employer's liability, there would have been a provision like section 65(8)3 of the *ESA*, which plainly states that a successor employer is entitled to set off or deduct from the severance amount a prior payment of severance pay by a predecessor employer.[24]

To avoid the risk of uncertainty to purchasers in attempting to avoid future *ESA* obligations, purchasers should instead contract to have the vendor indemnify them for all *ESA* liabilities if the purchaser cannot avoid their payments. However, given that the vendor is ordinarily no longer financially viable after the closing funds have been disbursed, it may still be worthwhile for a purchaser to require a vendor with substantial severance pay obligations to terminate the employees with all *ESA* statutory entitlements being paid immediately prior to the closing, with new contractual offers of employment from the purchaser becoming effective upon closing so that the purchaser can thereafter at least obtain the statutory set-off, noted above under section 65(8)3 of the *ESA*, for severance pay amounts previously paid by the vendor.

### (iii) Employment Implications Under The *Labour Relations Act*

Section 69 of the *OLRA* specifically governs the sale of a business. As recognized in *Abbott v. Bombardier,* the unionized context is quite different than the individual employment context with respect to statutory protections upon the sale of a business. Section 69 of the *OLRA* does not define business, although it does define "sells" to include "leases, transfers and any other manner of disposition". Section 69(2) and (3) provide that upon the sale of a business, the purchaser continues to be bound by the collective agreement until the Labour Board declares

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[24] *Jegasothy v. The Label Depot Inc*., 2003 CanLII 48602 (ON LRB) at para 12.

otherwise. Further the purchaser becomes the new employer of all members of the bargaining unit, who continue to be represented by the union as their bargaining agent.

While these provisions are generally interpreted liberally in favour of the employees and union, not all commercial transactions will be found to involve the sale of a business for the purposes of the *OLRA*. A pure subcontract, without the transfer of any assets, generally does not have the effect of transferring labour relations obligations to the subcontractor.

The purchaser's intentions concerning the operation of the business following the sale are a relevant consideration in determining whether bargaining rights attach to the purchaser. For example, a union's bargaining rights often attach to a geographic area; if the purchaser intends to move its operations to a different location, the union's right to bargain for the employees will not extend outside the region in which it was certified.

A purchaser should carefully consider whether its business plan is feasible within the bounds of a current collective agreement prior to a purchase. While the purchaser will benefit from an experienced workforce that comes with the business, it may be prevented by the collective agreement from subcontracting areas of work or changing certain conditions of employment, and it may be bound to retain employees it would prefer to terminate as there can be no termination under a collective agreement without just cause.

## III. CONCLUSION

Counsel advising clients on the sale or purchase of a business must carefully consider obligations to employees as an integral part of any transaction.

At common law, the sale of a business traditionally results in an automatic termination of the employee's contract with the vendor. However, unless a clear and explicit term of the new employment contract dictates otherwise, and provides adequate consideration, courts are likely

to find an implied term that an employee's prior service will be recognized for the purpose of calculating reasonable notice of termination at common law when the employee is eventually terminated by the purchaser. While such an implied term only applies where a business has been transferred as a going concern, the Court will be liberal in its interpretation to the benefit of the employees.

Section 9 of the *ESA* reverses the traditional common law assumption by dictating that upon the sale of a business, employment is deemed not to be terminated for the purpose of *ESA* entitlements. The going concern test does not apply, such that the sale of a business is broadly defined to include all or part of a business and may even include some outsourcing transactions. The application of section 9 is difficult to avoid, perhaps even when employees are properly terminated and paid their *ESA* termination entitlements prior to the sale.

A union's collective bargaining rights normally transfer to the purchaser when a business is sold. A purchaser is well advised to consider what changes to the collective agreement it might wish the vendor to try to negotiate with the union prior to the sale, and should be aware of any outstanding grievances and limitations on its abilities to make changes to terms of employment and to the workforce.

As counsel for a purchaser, you should ensure that the vendor is contractually obliged to disclose as much information as possible about the employment aspects of the business and the age, tenure, compensation terms and character of employment of the employees. Potential common law and statutory employment liabilities must be considered in full and financially accounted for, through payment and/or indemnities, in any purchase and sale negotiation by both parties.