

HR in Acquisitions: Overview

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This Practice Note provides an overview of purchase agreement (whether assets or shares) and due diligence considerations relevant to the acquisition of a private sector business with employees who are regulated by Ontario law in their employment relationships. This Practice Note does not address pension and benefits or non-competition or non-solicitation by the vendors post-closing.

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Contents

Purchase of the Assets of a Business

Legal Framework

Representations, Warranties and Covenants

Frequently Encountered Scenarios

Purchase of Shares

HR Due Diligence in Acquisitions

Purchase of the Assets of a Business

Legal Framework

When a purchaser acquires all or substantially all of the assets of a vendor's business, the purchaser and the vendor are generally free to negotiate which, if any, of the vendor's non-union employees will be offered employment by the purchaser and which, if any, will remain employed with the vendor. If the purchaser chooses not to offer employment to a vendor's employee, or if an employee chooses not to accept the offer, then the employee's employment will typically be terminated and she will have grounds for a claim against the vendor for, among other things, notice of termination or pay in lieu of notice. The vendor will, therefore, typically wish to take steps to negotiate provisions into the asset purchase agreement to reduce or avoid this potential liability, to the extent possible.

In that regard, the parties to the transaction should be aware of three main sources of law that may govern the employment of the employees, namely:

- Statute.
- Common law.
- Contract.

Statute

The *Employment Standards Act, 2000*, S.O. 2000, c. 41 (ESA) prescribes minimum standards of employment for all Ontario private sector employees governed by provincial jurisdiction. Under section 9 of the ESA, if there is a sale of a business by the vendor to the purchaser, and a vendor employee accepts the purchaser's offer of employment, the purchaser must recognize the employee's past service with the vendor for all ESA purposes. In these circumstances, the ESA deems the employee's employment to be continuous for all ESA purposes, provided the employee ceases employment with the vendor and commences employment with the purchaser within 13 weeks of the date of the termination (usually, the closing date of the transaction).

If a vendor employee's employment is instead terminated with the vendor and not continued with the purchaser within 13 weeks (including if the purchaser offers the employee employment and the employee rejects it), then the employee is entitled to receive ESA minimum notice of termination or pay in lieu of notice.

If the vendor has an annual payroll of \$2.5 million or more and the employee has completed at least five years of service with the vendor (as of the end of the notice period), she will also be entitled to ESA severance pay, calculated as one week's notice for every year of service (and a part week in proportion to each part year as of the end of the notice period), to a maximum of 26 weeks.

There is no reduction in these obligations of the vendor if the employee finds new employment or self-employment after her termination from employment. Unlike the position at [Common Law](#), there is no mitigation principle that applies to termination or severance pay under the ESA.

In the termination context, the ESA requires that an employer pay a terminated employee her accrued vacation pay calculated up to the end of the employee's ESA notice period. In the context of an asset transaction, if the employee accepts employment with the purchaser, the normal practice is for the purchaser to assume the vendor's accrued vacation obligations to the employee as of the date of the closing of the transaction. The vendor may then give the purchaser a purchase price adjustment, reimbursement or other form of credit to compensate the purchaser for assuming these obligations.

Common Law

The technical position at common law is that, upon the purchase of the assets of a business, each of the vendor's employees is dismissed from employment. As noted under [Legal Framework](#), the dismissed employees will then typically have grounds for claims against the vendor for, among other things, notice of termination or pay in lieu thereof. However, an employee has a common law duty to try to mitigate any losses arising from the dismissal and is, therefore, obliged at law to seek and accept comparable, alternative employment.

Accordingly, purchasers often agree in the asset purchase agreement to offer employment to most, if not all, employees of the vendor upon the closing of the transaction on the same or substantially the same terms and conditions as these employees were employed under with the vendor. Provided they each accept an offer of employment (as they are generally expected to do under the common law mitigation principle discussed above), the employees will typically not suffer any damages at common law with respect to the termination of their employment with the vendor. An employee who refuses an offer of employment on the same or substantially the same terms and conditions will likely be deemed to have failed to mitigate her damages and will, therefore, probably have no claim for wrongful dismissal damages against the vendor.

However, it is possible that an employee who accepts an employment offer with the purchaser but then ceases employment with the purchaser within the common law notice period running from the termination date (usually, the closing date) will have a basis for a wrongful dismissal claim against the vendor or the purchaser, or both, for common law notice less employment income received from the purchaser. The vendor may, therefore, try to seek protection against this potential liability in the asset purchase agreement, including through covenants from the purchaser to continue to employ the employees for a minimum guaranteed period from the closing date and indemnities.

If the purchaser offers employment to the vendor's employees, the costs associated with dismissing the employees without cause in the future will relate to the entire combined period of employment with the vendor and the purchaser and not just for the time period employed with the purchaser (subject to any enforceable agreement between the purchaser and the employee). The costs of dismissing employees (especially long-service employees) without cause can, therefore, be significant in Ontario.

If, however, the purchaser does not wish to offer a vendor's employee employment on the same or substantially the same terms and conditions, the vendor may look to the purchaser for reimbursement or compensation for the liability it may face with respect to the termination of the employee's employment, such by indemnification under the asset purchase agreement.

Employment Agreements

The parties to a mergers and acquisitions (M&A) transaction should always consider whether there is any binding written employment agreement in effect that could be triggered directly or indirectly by the transaction. For example, the agreement may contain change of control or termination provisions that may be triggered by the transaction.

A related consideration is whether there is any employment agreement in effect that contains an assignment or assumption provision, by which the agreement may be transferred to and assumed by the purchaser (if the parties wish that). This may be particularly attractive to the purchaser if the agreement contains provisions that may be advantageous to it after closing, such as termination provisions that provide for less than common law entitlements or restrictive covenants that exceed the employee's basic common law obligations.

If there is no written employment agreement in effect, the ESA and the common law will govern, as discussed under [Statute](#) and [Common Law](#) respectively.

Representations, Warranties and Covenants

In both asset and share purchase transactions, the purchase agreement will typically include various representations, warranties and covenants to:

- Identify matters and facts pertaining to the vendor's workforce and business.
- Set out closing and post-closing obligations of the parties.

Vendor's Representations and Warranties

The representations and warranties provided by a vendor will usually cover a variety of subject matters and address both existing and anticipated liabilities.

To begin with, the purchaser should request that the vendor provide an employee list, identifying all relevant employees. A vendor will usually represent and warrant that it has provided the purchaser with a current list of those employees who may form part of the transaction. This list should provide such information as:

- Each employee's:
 - title;
 - years of service;
 - salary or wage rate; and
 - bonuses, commissions, other incentives, perquisites and any additional employment income (including under equity compensation plans).
- Whether or not the employee is currently away from work (for example, on a leave of absence or disability).

This list can also contain details about the vendor's directors, officers, agents, consultants or contractors.

The purchaser will usually ask the vendor to:

- Represent and warrant that it has provided the purchaser with all material employment agreements and templates.
- Covenant that the vendor will not provide any salary increases, additional compensation (for example, change of control payments), acceleration of benefits or loans to any of its employees, directors, officers or consultants, whether or not in connection with the transaction, unless it is otherwise disclosed or in the ordinary course.

The purchaser will also wish to ensure that it has no liability with respect to any pre-existing payment obligations that are triggered in connection with the transaction, such as change of control payments.

Typically, the purchase agreement will also contain representations and warranties that:

- The vendor is not subject to any pending, threatened or anticipated claim or legal proceeding involving any current or former employee, officer or director.
- The vendor has acted in compliance in all material respects with all applicable laws.
- All assessments, levies and penalties under the *Workplace Safety and Insurance Act, 1997*, S.O. 1997, c. 16 (WSIA) have been fully paid and that no reassessment has recently taken place. As a closing condition, the purchaser may also require the vendor to obtain and provide a satisfactory purchase certificate, issued under the WSIA.

If the vendor's employees are not unionized or members of an employee association, the purchaser will usually wish the vendor to represent and warrant that there are no collective agreements applicable to its employees and that none of them are represented by any bargaining agents. The purchaser may also request a

representation and warranty from the vendor that there are no pending applications for union certification and that the vendor has not committed to negotiate to voluntarily recognize a bargaining agent or to enter into a collective agreement.

Covenants

In an asset purchase transaction, if an employee does not receive an offer of employment from the purchaser or chooses not to accept this offer, the employee will have a potential claim against the vendor arising from her termination of employment (unless the employee can be kept and integrated into any remaining business that the vendor may have after the closing). However, as noted under *Common Law*, the vendor will typically include a covenant in the asset purchase agreement requiring the purchaser to extend offers of employment to those employees it wishes to go with the business, on the same or substantially the same terms and conditions of employment (or to a similar standard) and with recognition of their prior service.

The vendor may also require the purchaser to extend offers of employment to employees on various leaves of absence (for example, short- or long-term disability, pregnancy or parental leave). If so, the purchaser will often specify in the asset purchase agreement that the offer is conditional upon the employee's returning to work within a defined period. The vendor or the purchaser, or both, may be subject to human rights legislation complaints if any employee on a leave of absence is not presented with an employment offer.

A vendor may also include in the asset purchase agreement that it will have the right to review the form and content of the offers of continuing employment (or offer templates) before closing, to ensure that it is satisfied that the purchaser's covenants are being met.

Various other covenants may be negotiated into the agreement to cover a host of labour, employment or similar issues, concerns or liabilities that may arise from the transaction. The list of possible issues is virtually endless and varies widely according to the particular circumstances of each transaction.

Frequently Encountered Scenarios

Employees in Other Provinces and Territories

Some of the employees of the target business may be located in a province or territory other than Ontario.

Assuming that the employer is provincially regulated in its employment relations, the considerations in other provinces are substantially similar to those in Ontario, except for in Québec (where the applicable laws are materially different in certain key respects). One notable exception is that Ontario is the only province with statutory severance pay, under the ESA, as further discussed under *Statute*.

Mass Termination

The purchaser may plan to permanently close one or more of the acquired offices or plants after the transaction closes, resulting in the dismissal without cause of more than 50 employees at once or within a short time-span.

If the purchaser expects to permanently close one or more of the vendor's acquired establishments (such as an office building or plant) after closing, resulting in the termination of 50 or more employees within any period

of four weeks or less, section 58(1) of the ESA provides that all terminated employees with three or more months of service are entitled to certain minimum levels of notice (or pay in lieu). The minimum notice in such circumstances ranges from 8 to 16 weeks (for all employees, regardless of their respective periods of service). The notice must be provided to each terminated employee and depends on the total number of employees terminated in the four-week period (taking into account both terminations by the vendor before closing and terminations by the purchaser after closing). There are a number of exceptions to these requirements under the ESA and *Termination and Severance of Employment*, Ont. Reg. 288/01, which should be carefully considered.

The party effecting the mass termination is also required to provide the Ontario Ministry of Labour's Director of Employment Standards with prescribed information in writing relating to the termination, including:

- The number of employees to be dismissed.
- When.
- Any proposed adjustment measures.

This information must be filed before any effective written notice of termination is provided to employees.

If a business is permanently discontinued, causing the employment of 50 or more employees to be terminated in any period of six months or less, severance pay under the ESA must be paid to those terminated employees with five or more years of service (if they have not already qualified for ESA severance pay because the employer's annual payroll is \$2.5 million or more). See [Statute](#) for a discussion of severance pay.

These same considerations also apply in the context of a share purchase transaction where the purchaser expects to permanently close one or more of the target company's acquired establishments (such as an office building or plant) resulting in the mass termination of 50 or more employees within a four-week period (taking into account terminations in both the pre-closing and post-closing periods).

Existing Collective Agreement

All or a substantial portion of the non-management workforce may be subject to a collective agreement

In an asset purchase transaction where all or a substantial portion of the non-management workforce are subject to a collective agreement, the rights and obligations of the parties will be governed by the *Labour Relations Act, 1995*, S.O. 1995, c. 1, Sched. A (OLRA) and the applicable collective agreement.

Under the OLRA, the terms and conditions of the collective agreement and the bargaining representative's rights will continue unaffected after the sale of the business. Specifically, section 69 of the OLRA provides that, where a vendor is bound by a collective agreement and "sells" its "business" (which terms are both broadly defined in the OLRA and interpreted), the purchaser becomes bound by the collective agreement as if the purchaser had been a party to it. Post-transaction, the purchaser cannot contract out of the collective agreement and must recognize the continuing rights of the bargaining agent (the trade union) as the representative of the bargaining unit.

If the vendor's workforce is subject to one or more collective agreements, the purchaser will typically require the vendor to represent and warrant that the vendor has provided true and complete copies of the applicable

agreements for the purchaser's review and that the vendor is not in violation of any agreement. The purchaser will also typically wish the vendor to disclose:

- All pending, anticipated or threatened grievances.
- The status of any ongoing negotiations, unfair labour practice complaints or other similar applications.

Under the OLRA, in a sale of a business, unionized employees will have the right to continued employment with the purchaser on the terms and conditions of the applicable collective agreement. Offers of employment need not even be made to these employees. Their employment simply continues upon the closing of the transaction.

Expiring Collective Agreement

The vendor may be party to a collective agreement that has recently expired or is about to expire.

In an asset purchase transaction, where the unionized employees are subject to a collective agreement that is about to expire, the vendor and the bargaining agent may be negotiating the agreement's renewal. The vendor will be subject to the duty to bargain in good faith under the OLRA, and it should, therefore, consider whether to disclose the transaction to the bargaining agent (at least before completing the renewal of the collective agreement).

The purchaser will typically wish to inquire of the vendor with respect to these matters and to consider adding language to the purchase agreement to guard against inherited liability as a successor employer for any failure by the vendor to meet its legal obligations under the OLRA.

The purchaser will also typically wish to:

- Get the measure of whether the parties are heading towards a strike, lockout or other labour disruption.
- Ensure that the vendor is not negotiating towards an unfavourable new collective agreement.

The collective agreement should also be examined to assess whether it requires that advance notice of the transaction be given to the collective bargaining agent. This provision is uncommon but potentially problematic.

Purchase of Shares

In a share purchase transaction, the legal identity of the employer does not change. The shares of the employing entity change hands, but the employees remain employed by the same legal entity. Therefore, the purchaser will indirectly inherit all of the target company's:

- Employees and their respective entitlements, including under their employment agreements and bonus plans.
- Liability for any termination costs, accrued past service and so forth.

If the purchaser wishes to terminate any of the target company's employees post-closing, the target company will be subject to the same termination obligations and liabilities as it had under the vendor's ownership. The

purchaser may, therefore, wish to try to obtain a covenant requiring the vendor to dismiss or otherwise deal with selected employees before closing, at the vendor's cost.

The representations and warranties in the share purchase agreement should largely resemble those in an asset purchase agreement, as discussed under *Vendor's Representations and Warranties*, although the purchaser will typically be more concerned about the thoroughness of these representations and warranties in a share transaction, as it will be indirectly taking over the business "as is", with all of its liabilities.

HR Due Diligence in Acquisitions

The purchaser will typically wish to see the whole picture of the vendor's obligations and liabilities with respect to its workforce, through due diligence and related representations and warranties in the purchase agreement.

Consistent with the discussion under *Vendor's Representations and Warranties*, the purchaser should make numerous inquiries into the vendor's workforce, such as:

- The employee's locations.
- The number of employees.
- Their periods of service.
- Their titles.
- Their compensation and benefits arrangements.

The purchaser should also inquire into:

- The number of employees currently on leaves of absence.
- The circumstances surrounding these leaves.
- Whether and when such employees are likely to return to work.

It is also important for the purchaser to obtain and review the vendor's key employment documents, such as employment agreements, equity incentive compensation plans and personnel policies to identify any obligations and liabilities that may transfer with them to the purchaser upon the closing of the transaction. Among other things, the purchaser should request any documentation providing for potential change of control payments, acceleration of vesting or other payments or obligations that could arise from the transaction. If an employee has a written employment agreement or is subject to other plans, agreements or arrangements, the purchaser will wish to determine whether they can and should be assigned by the vendor to the purchaser, whether with or without the employee's consent.

The purchaser should request and review all:

- Current, pending and threatened employment and labour grievances, claims, complaints and demands.
- Recent workers' compensation claims, assessment rates and safety records.

The purchaser should also review all collective agreements, where applicable. It is important for the purchaser to identify the expiry dates of the collective agreements and note if advanced notice of a proposed transaction to the union is required. A purchaser will also typically want assurances that the relationship between the vendor and the union is co-operative and productive and that there have not been any strikes or work stoppages in recent years.

The *Occupational Health and Safety Act*, R.S.O. 1990, c. O.1 (OHSA) sets out the rights and duties of all parties in the workplace to provide and maintain a safe working environment. A purchaser should review all current and recent inspector's orders, charges and convictions relating to non-compliance with the OHSA.

The purchaser should also review all documentation relating to pending or anticipated audits or assessment under the WSIA and the vendor's recent accident record to ensure that the target business is being carried out safely and in accordance with legislation and that there is no outstanding fine or penalty.

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