THE PITFALLS OF "PURCHASING" EMPLOYEES

The sale of a business can have a substantial emotional and practical impact upon the employees. The related legal issues for purchaser and vendor, and for their lawyers, are no less significant.

Legally, the employment impacts of the sale of a business are numerous and they flow from both statutory sources and from the common law. They can be problematic, particularly (in my experience) when the existing employees flow to the purchaser of the business.

Most commonly, these issues seem to arise within a year or two after the purchase of the business. Although the purchaser often has the intention of keeping all the existing employees, things don't always work out that way.

This is partly due to the fact that very little due diligence is typically done in relation to individual employees. So, when a termination inevitably happens, there are questions as to which party (the vendor or the purchaser) is liable to satisfy the employee's entitlements and as to the extent of those entitlements.

These can be very expensive liabilities and the question of who holds them should be of significant concern to the parties early on in negotiations – both the vendor and the purchaser surely are seeking certainty in the transaction – rather than at the last minute or (worse) after the fact.

Employment Standards Legislation

In B.C., our Employment Standards Act deems employment to be continuous upon the sale of a business. So, for the purposes of the Act, employees who go to work for the purchaser do so with all their accumulated entitlements intact.

Their employment is deemed to have begun with their original date of hire, and their tenure remains unbroken for the purposes of entitlements such as vacation pay and severance pay. Any other claims which the employees had against the former employer (for instance, for unpaid wages and overtime, and statutory holiday pay) can also be directed against the purchaser.

In essence, for the purposes of the Employment Standards Act, the purchaser inherits the employees lock, stock, and barrel. Notably, the golden rule of employment standards legislation is that employees cannot contract out of their statutory rights.

The Common Law of Employment

The common law of employment applies consistently throughout Canada (with the exception of Quebec). Its effect, generally, is to impose a number of implied terms onto the employment relationship such as the entitlement to reasonable working notice in not-for-cause termination situations.

The common law of employment is enforced by the civil courts (unlike the Employment Standards Act and the Canada Labour Code, which are enforced by dedicated administrative bodies).

The parties can structure a purchase agreement to address responsibility for common law liabilities - whether they are to remain with the vendor or flow to the purchaser. But, there are uncertainties in all of this.

The civil courts have held, for instance, that in certain circumstances both the purchaser *and* the vendor may be liable to the employee. This will occur when the contractual status of the employee has not been adequately defined at the time of the sale.

Putting Safeguards In Place – Indemnifications and Holdbacks

For the vendor of a business to be certain that it does not retain liability for common law wrongful dismissal damages, it must establish a "novation" of contract. A novation has been described as a trilateral agreement by which an existing contract is extinguished and a new one (with another party) is brought into being.

To meet the burden of establishing that a novation has occurred in the employment context, the circumstances must indicate three things. First, it must be clear that the purchaser company has assumed the complete liability for the employee.

Second, the employee must have accepted the purchaser as the party holding liability. Finally, the employee must have accepted the new employment contract in full satisfaction and substitution for the old one.

These criteria can be fully addressed in properly drafted agreements (which, of course, must also be properly implemented). However, getting the wording correct is the key and for that the parties to the transaction are well-advised to seek expert assistance.

The risk that a civil court will not agree that a proper job was done means that there is no guaranteed method of ensuring which of the parties to the transaction will hold liability. To address this uncertainty, the best the parties can do is build indemnifications and hold-backs into the purchase agreement.

If I am representing the purchaser, I will urge it to hold back a portion of the purchase price for some reasonable period of time. If representing the vendor, I push for an indemnification to be obtained.

All of this suggests to me that parties to a business transaction of this type should involve employment lawyers earlier rather than later. It also suggests to me that everyone involved should recognize the uncertainties of the situation and should take steps to protect themselves from unwanted liabilities.

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