Fraser Milner Casgrain LLP

LEGAL GUIDE

Mergers And Acquisitions In Canada

Section 5: Labour Relations and Employment Considerations

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Labour Relations and Employment Considerations

Introduction

When acquiring the shares or assets of a Canadian private or public company, a number of employment issues need to be addressed. Since the issues in share acquisitions are very different from asset purchases, these two types of transactions are addressed separately.

Before discussing these issues, it is helpful to have an understanding of a few basic concepts of Canadian employment law. Set out below is background information on employment agreements and termination of employment.

Background Information

Employment Agreements

Employees may be employed under a written employment agreement, an oral employment agreement or a collective agreement.

In the unionized workplace, all employees in the bargaining unit are employed under the collective agreement, which is signed by the employer and the union. The Supreme Court of Canada has held that there is no room for individual negotiation or employment agreements in the unionized setting and that the collective agreement is the only employment agreement, with the union being the sole bargaining representative of the employees in the bargaining unit.

In the non-union workforce, employees are employed under a written or unwritten employment agreement. In Canada, written employment agreements are still relatively rare, especially in the lower ranks, although increasing in popularity. Any employees without a written employment agreement have, at common law, an oral employment agreement. It is for this reason that this section refers, from time to time, to the employment agreements of employees, even where there is no written document. Where there is no written term regarding termination of employment, it is an implied term of employment that employment will only be terminated for cause or upon reasonable notice.

Termination of Employment

Canadian severance laws are quite generous and there is no employment at will. It is important for the buyer of a corporation to understand the potential costs of a future reduction in the workforce, the scope of possible outstanding severance claims for dismissals that occurred before the acquisition date, and whether and how those obligations can be limited.

Regardless of where the target business is located, there are two levels of severance obligations to be assessed: statutory and common law (civil law in the province of Quebec).

Statutory Requirements

Each province and territory in Canada has local legislation which sets out the minimum notice period to be provided in the event of a termination of employment other than for just cause (which has a fairly narrow statutory definition). These amounts are fairly modest and are based on an employee's length of service. They generally range from one week to eight weeks of notice of termination, which can be provided as pay in lieu of notice if the termination is to be immediate. It is not possible to contract out of or waive these statutory requirements, even with the consent of the employee.

The statutory notice requirements increase significantly where group dismissals occur. Most provinces define a mass dismissal as the termination of 50 or more employees within a specified time frame. However, in some provinces, it is as low as 10 dismissals. The notice required in these situations can be as great as 18 weeks. There are often additional requirements, such as notifying the provincial Ministry of Labour of the impending terminations, posting notices in the workplace or assisting employees in securing new employment.

The Province of Ontario and the federal jurisdiction require payment of statutory severance pay in addition to notice of termination. The federal *Canada Labour Code*[61] (the "Code") applies only to federally regulated employers including airlines, banks, broadcasters, and those involved in telecommunications or interprovincial shipping, trucking and railroads. Most businesses are regulated by the laws of the province in which they operate. Fortunately, provincial employment legislation is fairly consistent across the country.

Unlike termination notice (which can be provided as time worked or as pay in lieu of notice of termination), statutory severance pay is always a cash payment. Ontario's severance pay requirements apply only to employees with at least five years of service and only to employers with an annual Ontario payroll of at least CDN$2.5 million. The severance formula is one week of pay per year of service, to a maximum of 26 weeks. Severance pay under the Code is the greater of five days' pay or two days of pay per year of service, and is only payable to those who have completed 12 months of continuous service with the employer.

A very small number of jurisdictions (namely Quebec, Nova Scotia and the federally regulated sector) have legislation requiring just cause for the dismissal of employees with a certain amount of seniority. The federal rule does not apply where the termination is a result of lack of work or the discontinuance of a function. In these jurisdictions, government tribunals have the power to award damages or reinstate employees dismissed without cause.

Common Law and Civil Law Requirements

Of far more significance than the modest statutory termination requirements are the Canadian common law and the Quebec civil law requirements.

Where an employee is dismissed for cause, there is no advance notice of termination or severance pay required whatsoever. Not surprisingly, "cause" has been narrowly defined by our courts as certain acts including fraud, dishonesty, gross incompetence, serious sexual harassment, conflict of interest, theft and sometimes serious insubordination. All other terminations of employment, including a redundancy

61 (R.S., 1985, c.L-2).

or downsizing, are terminations without cause and the amount of notice of termination required under the contract of employment must be given.

If there is no express termination provision in the employment contract, the courts imply an obligation to provide reasonable notice. Reasonable notice is determined on the basis of a number of factors such as the individual employee's length of service, position, age and compensation. A civil claim for severance where there was no cause for the dismissal, is known in Canada as a wrongful dismissal claim (although there is no connotation of any wrongful activity. It is "wrongful" only to the extent that insufficient notice was given). "Reasonable notice" at common law is very generous and, when making an estimate of severance costs, one month per year of service provides a rough guideline, although it is not entirely reliable. Reasonable notice generally does not exceed 24 months in total.

Where an employee has signed an employment agreement which contains notice or severance terms, the contractual terms are generally binding. Courts will refuse to uphold severance provisions which provide less than the provincial legislation or where the employee received no consideration for signing the employment agreement (for example, employment had already commenced before the contract was signed). In some cases, the courts may also refuse to enforce an employment agreement where: the contract was unconscionable; the employee was coerced into signing it; the employee did not understand the contract; or, where the contact was signed so many years earlier that, with subsequent changes in function, position or size of the company, the contract is no longer relevant.

Acquisition of Shares

A change in ownership of share equity does not change the identity of the employer. The acquired corporation, despite the change in ownership, continues to be the employer under any employment agreements and any collective agreement with a trade union.

Because there is no termination of employment, there is no break in service or seniority of the employees. The purchaser inherits all of the past service and the associated termination obligations.

In the case of a unionized workplace, the collective agreement remains in place and continues to govern all terms and conditions of employment and to bind the corporation.

Due Diligence

As the new owner acquires all of the liabilities of the corporation in a share acquisition comprehensive due diligence is critical. The potential buyer should assess the cost of any outstanding employee-related liabilities. For example, there may be outstanding wrongful dismissal lawsuits, complaints under human rights legislation, workers' compensation penalties, occupational health and safety charges, complaints under employment standards legislation or grievances in a unionized workplace. It is also prudent to obtain a history of recent reductions in workforce and individual terminations.

Canadian employees are fairly litigious in dismissal situations. It would be wise for a new owner to determine if there are any outstanding severance claims where a release has not yet been obtained and where the dismissal occurred within the last two years. Limitation periods for wrongful dismissal claims vary from two to six years.

During due diligence, a potential buyer should review all employment agreements, severance agreements and change in control agreements. This is especially important where the buyer plans to downsize the workforce in the future. The current cost of administering the payroll, benefits, pension plan and workers' compensation premiums should be reviewed. But, equally important, the buyer should look for agreements that increase any of these costs in the near future.

Workers' compensation coverage in Canada is not administered through private insurance. Rather, employers pay premiums to a provincial fund based on the size of the payroll and type of industry. A provincial government body makes all claims decisions.

The usual payroll taxes include income tax, Canada Pension Plan (or Quebec Pension Plan) contributions (there is an employee and an employer contribution toward this government-run pension scheme) and Employment Insurance premiums (there is an employee and an employer component to the government-run insurance plan which provides benefits during periods of unemployment, maternity/parental leave, disability and compassionate care leave). Some provinces have payroll taxes to pay for healthcare, while others have premiums paid to the provincial government medicare plan. Workers' compensation premiums are paid to the applicable provincial workers' compensation board.

Any collective agreements should be reviewed carefully. Depending on the future plans of the purchaser, the following issues should be addressed: Are there any restrictions on contracting out, subcontracting or plant closures? Are there any severance terms? (Severance clauses are not overly common in collective agreements as all unionized employees are protected by the provincial employment standards legislation.) What is the scope of the union's bargaining rights? (For example, do they cover all employees, including office employees, production employees, part-time employees and students? Do the bargaining rights extend to one particular street address, to the entire municipality or even the entire province? Could they apply to other operations already owned by the buyer?)

As well, a collective agreement can reveal future costs in terms of scheduled pay and benefit increases. The manner in which the pension and benefits are structured can restrict the buyer's flexibility in changing plans. If, for example, the carrier and type of coverage is specifically set out in the collective agreement, it would be a breach of the contract to change carriers or plans.

The term of the collective agreement will reveal when the contract expires and when labour unrest or a strike could next occur.

Depending on the type of business conducted by the target company, a review of any non-competition, non-solicitation, non-disclosure and intellectual property rights agreements can be helpful.

Representations and Warranties

In addition to conducting thorough due diligence, the buyer of shares should require certain representations and warranties from the seller. Typical representations and warranties include the following statements: that all payroll taxes and premiums are current; vacation pay has been accrued; there is compliance with applicable employment, labour and health and safety laws; there are no outstanding grievances, arbitrations, complaints or employee claims; there are no outstanding occupational health and safety charges or orders; and that there is compliance with pay equity laws (there is pay equity legislation in the private sector in the provinces of Ontario and Quebec, and in the federal sector). There should also be a representation and warranty as to whether there is any known union or employee association organizing activity, contemplated work stoppages or pending applications for certification by a union.

It is also possible to obtain certificates from certain government agencies as to whether workers' compensation premiums have been paid in full, or if there are any outstanding statutory complaints or charges. However, the procedure can be time consuming and typically the seller must authorize the disclosure in writing. Accordingly, the purchaser should be prepared to clarify these matters through due diligence and/or require appropriate representations and warranties.

Asset Purchase

In an asset purchase, there is a change in employer and, technically, all employees are terminated at the moment of sale. However, if the employees are rehired by the purchaser, severance costs are avoided because each Canadian jurisdiction has "sale of business" legislation which provides that where a business or part of a business is transferred, disposed of or sold to a purchaser, and the purchaser employs the employees, the employees' service is deemed unbroken for purposes of the legislation. Similarly, at common law, if an employee accepts equivalent employment with the purchaser, he or she has mitigated any wrongful dismissal damages. If the employee declines an offer of comparable employment from the purchaser, he or she has failed to mitigate and in any claim for damages at common law damages will be limited or not awarded. In some provinces, such as Ontario, employees have the right to refuse an offer of employment from the purchaser and still receive their statutory termination and severance pay.

Occasionally, purchasers from outside Canada seek to hire the employees of the target business as new hires with no past service. This is ineffective for statutory severance purposes, as employment standards legislation protects past service and employees cannot contract out of these statutory rights. At common law, while it is possible to avoid past service, this would be unusual and may not be acceptable to the seller. As well, this would have to be explicitly stated in each employee's offer letter or contract and carefully drafted to ensure that it does not run contrary to the employment standards legislation.

Due to the cost of severance (and often out of concern for the employees), the seller will typically try to require the purchaser to hire all of the employees. As well, the seller will normally want a clause requiring the purchaser to make offers of employment on terms and conditions that are substantially similar in the aggregate to those enjoyed by the employees before the sale. Obviously, if the offers are inferior, the chances increase that the employees will not accept the purchaser's offers. Unless the asset purchase agreement allocates liabilities otherwise, the severance costs will be to the account of the seller. An asset purchase can allow a purchaser more flexibility as to how many employees it wishes to assume and on what terms, subject to what it can negotiate with the seller.

A purchaser should be aware that a unilateral adverse change to significant terms and conditions of employment (especially with respect to pay, bonus plan, calculation of commissions or benefits) made after the purchase can constitute a constructive dismissal. Where an employee does not accept an adverse change, he or she is entitled to quit and sue for damages for constructive dismissal. If changes to employment arrangements are contemplated and the purchase is by way of assets, the time to set them out is in the offer letter to the employee.

The comments above with respect to due diligence and seller's representations and warranties, apply equally to asset transactions. The asset purchase agreement normally should provide that all employee costs and claims that arose before the closing date are to the account of the seller, and all costs arising after the closing date are the responsibility of the purchaser.

The Unionized Workplace

Labour relations legislation across Canada contains similar sale of business or successorship provisions, which apply to the purchase of a unionized business whether by assets or shares. The legislation stipulates that the purchaser is bound to the collective agreement as if it were the original signatory to the contract. In other words, the purchaser must recognize the union as the exclusive bargaining agent for the employees and is bound to the collective agreement. Accordingly, the typical asset purchase agreement will require the purchaser to continue the employment of all unionized employees on identical terms and conditions of employment. There is normally no need to make any offers of employment; employment simply flows through from the seller to the purchaser. To change any of the terms and conditions of employment would constitute a breach of the collective agreement and could be taken to arbitration by the union. If the purchaser does not wish to hire all of the unionized employees, the layoff, bumping and seniority provisions of the collective agreement must be followed to effect a reduction in the workforce.

Generally, the provincial Labour Relations Boards distinguish between the purchase of discrete assets and the purchase of a viable business. Therefore, in some cases where only certain equipment is purchased and there is no value allocated to goodwill or, if the new business will be of a very different character than that carried on by the seller, the union successorship provisions may not apply.

The potential purchaser should be aware that if the seller is engaged in collective bargaining negotiations with the union while the sale is being actively contemplated, the seller has a statutory duty to disclose this significant development to the union at the bargaining table. Failure to disclose may constitute an unfair labour practice. In cases where bargaining is ongoing, the purchaser may wish to become involved in negotiations to some extent to ensure that the seller does not agree to an overly generous package with the union. Similarly, the purchaser may wish to become involved in order to ensure that the business is not headed towards a strike.

Employees on Leave of Absence

There are certain categories of absent employees that should be considered. A failure of a purchaser to offer employment to employees on sick leave or short-term disability could be construed as discrimination on the basis of disability. However, regardless of these concerns, purchasers typically will not wish to hire employees who are absent on long-term disability leave and agreements are often reached to leave these individuals on the benefit plans of the seller.

Employees absent on maternity or parental leave have a statutory right to reinstatement (which varies somewhat from province to province) and the seller will typically require the purchaser to hire all of these employees upon the expiry of their leaves of absence. Combined pregnancy and parental leave can be up to one year in length across the country (and up to 70 weeks in Quebec).

Similarly, in some provinces, employees who are absent due to a workplace injury and in receipt of workers' compensation benefits are protected under workers compensation legislation from termination of employment.

Amalgamations

An amalgamation does not create a new company. The usual analogy is that of two rivers flowing together to form one. Accordingly, there is no termination of employment of the employees. Nor are the liabilities and responsibilities of the two companies terminated.

When planning an amalgamation, due diligence should be conducted. The amalgamation may affect collective bargaining agreements (particularly if both companies have union agreements or business operations that are geographically close), stock option plans and employee benefits in particular.

It will also be necessary to comply with the registration requirements of the workers' compensation board in the province in which the amalgamation occurs, and to notify or register with other government departments. The benefit plan carrier(s) should be notified as well.

Data Privacy

The scope of access during due diligence has been affected by the federal *Personal Information Protection and Electronic Documents Act*[62] ("PIPEDA"). PIPEDA stipulates that personal information in the control of the corporation (including information pertaining to customers, contractors and business partners) cannot be used or disclosed without the consent of the individual to whom the personal information applies. "Personal information" must be about an identifiable individual.

It is also possible that personal information pertaining to employees cannot be disclosed in certain cases. For example, if one is purchasing a federally-regulated business or employees are located in a province with its own privacy legislation, the employer cannot disclose personal information concerning employees without their consent although, fortunately, the provinces of Alberta and British Columbia have passed specific provisions to allow for disclosures during the sale process. Even in other provinces such as Ontario, which does not have its own private sector privacy legislation, employees' personal information cannot be disclosed under PIPEDA during a commercial activity, without their consent. The sale of a business may well meet the definition of a commercial activity. As a prudent measure, where a data room is set up for multiple potential bidders, identifiers linked to personal information should be deleted.

Any potential purchasers should be required to sign a comprehensive non-disclosure agreement, which provides that the potential purchaser will destroy or return all personal information disclosed during due diligence if the transaction is not concluded, and will protect the personal information in a manner comparable to that in which it is protected by the seller. Whenever possible, personal information should not have identifiers on it.

British Columbia and Alberta both have similar provincial privacy legislation that sets out a reasonable protocol which allows for disclosure of personal information in the context of an acquisition. It must be

62 2000, c.5.

borne in mind that the Province of Quebec has had personal information protection legislation in place since 1994. Local legal advice should be obtained if a transaction involves disclosure, use or transfer of personal information in Quebec.

Most provinces also have legislation relating to personal health information. If such information is involved, special consideration must be given to protecting its privacy.

Conclusion

Employment and labour issues can be of key significance in the acquisition of a business. Specialized legal advice should be obtained in each case to assess the risk in opportunities that are being explored and to minimize liabilities to the greatest extent permissible by law in the circumstances.

About FMC

Fraser Milner Casgrain LLP (FMC) is one of Canada's leading business and litigation law firms with more than 500 lawyers in six full-service offices located in the country's key business centres. We focus on providing outstanding service and value to our clients and we strive to excel as a workplace of choice for our people. Regardless of where you choose to do business in Canada, our strong team of professionals has extensive knowledge and expertise on regional, national and cross-border matters. FMC's well-earned reputation for consistently delivering the highest quality legal services and counsel to our clients is complemented by an ongoing commitment to diversity and inclusion to broaden our insight and perspective on clients' needs.

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At FMC, we understand the complexities posed by changing market conditions. We know that to serve your needs effectively, we must understand your business and objectives in a broad context in order to anticipate developments, identify opportunities and respond to challenges.

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We believe, first and foremost, that our success is tied directly to the success of our clients. As such, our approach is client-focused and results-driven. We offer pragmatic advice and our effort is a collaborative exercise, led by the appropriate partner and assisted by the appropriate professionals.

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Our Mergers and Acquisitions Group acts on takeover bids (hostile and friendly), amalgamations, arrangements, and other business combinations involving public or private companies, as well as share and asset purchases and joint ventures. Our firm provides innovative and sophisticated advice on all matters arising in connection with M&A transactions, including tax, competition, *Investment Canada Act* compliance, financing, environmental, government relations, employment, pension and intellectual property law. We provide strategic advice, prepare all documents, and appear before securities commissions and courts whenever challenges need to be made or defended.

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