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## The International Scene

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### Purchasers of Canadian Businesses: Beware of Successor Employer Laws



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Now that the Canadian Wage Earner Protection Program (WEPP) has been in place for several years, some of the practical challenges created by the legislation can be better understood. The WEPP was enacted in Canada to ensure payment of certain liabilities owed to the former employees of a company that is bankrupt or subject to a receivership. The WEPP charges the Canadian receiver or trustee in bankruptcy with the responsibility for determining wages, vacation pay, termination pay and severance pay owed to former employees. The interaction between the WEPP and successor employer laws that apply in Canadian provinces and certain federally regulated companies has significant implications for insolvent employers, prospective purchasers and other stakeholders.

For reasons described in this article, in some engagements, a receiver or trustee responsible for administering the insolvent estate is put in a difficult position when calculating termination or severance pay pursuant to the WEPP due to the complexities of the laws governing a successor employer. The authors will first explore this challenge as it affects receivers and trustees, then address the challenge as it affects prospective purchasers of an insolvent business in Canada. The authors refer to employment standards legislation in Ontario (Canada's most significant commercial jurisdiction), but similar issues can arise for businesses in other provinces or subject to the federal employment standards prescribed by Part III of the Canada Labour Code (CLC).

#### Termination and Severance Pay Entitlements

Termination and severance pay entitlements are determined by the applicable employment standards legislation. In Ontario, these entitlements are generally governed by the Employment Standards Act

(ESA).<sup>1</sup> A receiver or trustee must consider these entitlements in order to comply with its obligation to determine the amounts of termination and severance pay owed to an employee under the WEPP. In an attempt to maximize the proceeds of realization, the receiver or trustee will frequently sell the assets of a business as part of an *en bloc* transaction. In many instances, the purchaser will extend employment offers to former employees and may be considered a "successor employer" under the ESA, CLC or similar legislation in other provinces.<sup>2</sup>

A purchaser can become a successor employer if it acquires all or a part of a business and hires employees previously employed by the vendor. In such circumstances, employment standards legislation deems the employees to have been continuously employed by the previous employer from the time they commenced employment with the previous employer. The consequences of being a successor employer are potentially significant. The purchaser, by operation of law, inherits accrued termination pay, severance pay and certain pension liabilities, which previously belonged to the seller. If a former employee is hired by a successor employer within 13 weeks of the earlier of his or her last day of employment with the seller and the day of the sale, then the former employee may not be entitled to termination pay or severance pay since the ESA deems his or her employment not to have been terminated, and prior service with the seller will be carried over to the purchaser.

#### Challenge for Receivers and Trustees

This situation poses a problem for the receiver or trustee, since it is the receiver or trustee who

<sup>1</sup> For unionized workers, the provisions of the collective agreement and the related labor statute must also be considered; for example, in the case of Ontario, the successor employer position of unionized employees generally will be subject to the provisions of the Ontario Labour Relations Act, as well as any relevant collective-bargaining agreement.

<sup>2</sup> The term "successor employer" is used in this article to refer to cases where the applicable employment standards legislation treats a purchaser as being the employer, on a continuous basis, of employees who were previously employed by a seller.

must determine the amount of the insolvent vendor's termination and severance pay liabilities pursuant to the WEPP. If former employees have been hired by a successor employer, they may not be entitled to any termination or severance pay. Conversely, if the purchaser is not a successor employer, the employee is then entitled to termination and severance pay. The determination of whether or not a company purchasing assets and hiring employees is a successor employer is complex, and the following factors should be considered:

- the physical assets acquired by the purchaser;
- whether goodwill, customer lists, trademarks and other intangible assets are acquired by the purchaser;
- the nature of the business carried on by the purchaser after completing the transaction in comparison to that previously carried on by the debtor;
- the number of employees that are transferred or retained by the purchaser and the type of jobs assumed;
- the length of time between the debtor ceasing to carry on his or her business and the purchaser commencing the business; and
- whether there has been a change of control.<sup>3</sup>

A receiver or trustee may not have adequate information with respect to all of the above-mentioned factors. Moreover, the answer to the question of whether a purchaser is a successor employer may not be clear or obvious, even for experienced employment lawyers. Finally, the receiver or trustee may not even know if an employee was subsequently hired by the purchaser, which is particularly an issue for employees not hired for several weeks after their initial termination. The WEPP requires calculating severance and termination amounts within 45 days of the receivership or bankruptcy. As noted, in Ontario, an employee can keep termination and severance pay entitlements if hired by a successor employer up to 13 weeks after his or her employment with the vendor is terminated. This timing gap can create significant practical challenges.

The responsibilities imposed on a receiver or trustee can no doubt put him or her in a difficult situation. On the one hand, the receiver or trustee does not want to indicate that an employee is owed termination or severance pay and then have these amounts incorrectly paid to employees. On the other hand, a receiver or trustee does not want employees to miss out on termination or severance pay to which they are entitled, which may result in a liability for the receiver or trustee. Also, treating employee entitlements as if the purchaser is a successor employer can strain a transaction, as the purchaser will frequently want to take the position that it is not a successor employer.

There are several approaches that the receiver or trustee can take to resolve this dilemma. In a case where this sort of situation is anticipated, hiring a law firm with a strong employment law practice is essential. If it appears likely that certain employees may not be entitled to termination or severance pay due to being hired by a successor employer within the 13-week period, it may be appropriate to raise the issue with the purchaser in advance, such as by adding a clause in the sale agreement that the purchaser undertake to provide the receiver or trustee with a list of the employees that it has hired. If the receiver or trustee believes that employees are not entitled to termination or severance pay, it is advisable to clarify this in the WEPP package sent to employees, as doing so provides

an opportunity for employees to challenge the calculations of the receiver or trustee, thus minimizing the risk of personal liability for the professional. Finally, if there is a single person or a small group that will benefit from a sale, it may be appropriate in some circumstances to request an indemnity to protect the receiver or trustee from personal liability or maintain an appropriate holdback from a distribution to the creditors.

## Concerns for Purchasers

A prospective purchaser of a Canadian company is also put in a difficult situation due to uncertainties surrounding termination and severance pay liabilities. This is particularly the case in an insolvency context when the decision of a receiver or trustee to treat the purchaser as a successor employer when preparing WEPP calculations can highlight the successor employer liabilities that the purchaser may be assuming by operation of law.

In some instances, purchasers have asked new employees to sign contracts acknowledging that they will not claim any successor employer rights if they are terminated at a later date; however, it is not possible for an employee to "contract out" of the ESA, and such terms in an employment contract are likely not enforceable.<sup>4</sup> It is best for a purchaser to quantify termination and severance pay liabilities along with certain pension liabilities as part of their due-diligence efforts and ensure that the amount of the purchase price that it is willing to pay takes into account the assumption of these obligations. This can only be done with precision if the purchaser determines in advance exactly which employees it intends to hire. The issue of successor employer liabilities should be discussed with Canadian legal counsel, and where a purchaser is involved prior to the insolvency filing, it may be appropriate for the purchaser to discuss the issue with the receiver or trustee that is expected to be involved.

Where the target company is party to a collective-bargaining agreement (CBA), a purchaser of all or part of the business also becomes a party to the CBA by operation of law. Unlike other jurisdictions, such as the U.S., Canadian insolvency laws do not permit an insolvent debtor that is restructuring its affairs to disclaim or terminate CBAs without the agreement of the relevant union.<sup>5</sup> Again, this makes it critical for any purchaser to understand the employer's past and future obligations under any CBAs so that it can make an informed decision about how much it is prepared to pay for the business. The issue is even more important if the CBA requires the employer to continue to fund one or more defined benefit pension plans. In such a circumstance, the purchaser would assume, by operation of law, the obligation of the employer to fund any solvency deficiency in such plan(s). All of the above issues highlight the importance of obtaining timely professional advice on the WEPP and successor employer-related issues. **abi**

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<sup>3</sup> Canadian Association of Insolvency and Restructuring Professionals, National Insolvency Qualification Program, Course 301, 2007, pp. 5-51.

<sup>4</sup> Employment Standards Act (Ontario), 2000, S.O. 2000, Chapter 41, s. 5(1).

<sup>5</sup> Bankruptcy and Insolvency Act (Canada), R.S.C., 1985, c. B-3, s. 65.11(10)(c) and Companies' Creditors Arrangement Act (Canada), R.S.C., 1985, c. C-36, s. 32(9).