BUYER BEWARE! WAIVING PAST SERVICE ISN'T POSSIBLE UNDER EMPLOYMENT STANDARDS LEGISLATION

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It is common for a purchaser of a business to try to limit its liability in connection with the years of service a transferred employee has with the vendor. Knowing how expensive it can be to dismiss employees with longer service, purchasers often ask the vendor to dismiss the employees prior to the closing of the transaction, or have the employees resign to try and limit the inherited liability. However, purchasers have to be careful in how they structure such arrangements.

In a recent decision,[1] the Ontario Court of Appeal confirmed that a purchaser cannot contract out of its *Employment Standards Act*, 2000 ("ESA") obligations with respect to an employee's prior service, even for the principal shareholder of a vendor.

The Facts

Wayne Groves founded UTS Consultants Inc. ("**UTS**") in 1992, serving as its officer and director for many years. In 2014, Mr. Groves, along with his spouse and a third shareholder, entered into a Share Purchase Agreement (the "**SPA**") to sell 100% of their shares in UTS to Oakville Enterprise Corporation ("**OEC**"). Pursuant to the terms of the SPA, Groves gave his notice of resignation as an officer and director of UTS.

At the time of the SPA, both parties contemplated that Mr. Groves would continue to work for UTS. Mr. Groves entered into an employment agreement with UTS. The termination clause in the employment agreement provided for three to twelve months' pay in lieu of notice, and for the exclusion and release of any prior service entitlements. In addition to the employment agreement, Mr. Groves signed a Release in connection with the SPA, which released UTS from any of Mr. Groves' claims "for unpaid remuneration, termination or severance pay," related to his previous service.

In 2017, UTS terminated Mr. Groves without cause. Mr. Groves commenced an action for wrongful dismissal.

Superior Court Decision

Justice Nishikawa found that although Mr. Groves resigned as an officer and director of UTS, he did not resign as an employee.[2] The SPA and the resignation that followed did not sever the employment relationship

between Mr. Groves and UTS – in fact, the Court considered it an artificial attempt to sever.

Justice Nishikawa held that the termination clause in the employment agreement and the release were void for violating section 9(1) of the *ESA*. Section 9(1) deems that an employment relationship continues following the sale of a business when the employee continues to work for the purchaser of the business. This is particularly relevant for calculating *total* period of employment: the length of employment under old ownership and new ownership must be added together. On this basis, Justice Nishikawa held that the termination provision was unenforceable – it required Mr. Groves to waive his prior service. Similarly, the release failed under section 9(1) as Mr. Groves could not release his entitlements for prior service for the purposes of termination and severance pay calculations – both of which are entitlements under the *ESA*.

The Ontario Court of Appeal

In dismissing UTS' appeal, the Court of Appeal confirmed that the *ESA* is applicable to employment relationships connected to commercial transactions. The Court found no basis to interfere with Justice Nishikawa's interpretation of the release and the termination clause, finding that both violated the *ESA*.

Lessons for Employers

Provisions of an employment agreement that attempt to contract out of ESA minimums are unenforceable,[3] and termination provisions that do not comply with the ESA are routinely struck down by courts.

UTS relied on the fact that Mr. Groves was the principal shareholder and argued that the resignation had to be considered in the context of a commercial transaction. The Court was clear, however, that he was still an employee and entitled to all of the protections set out in the ESA.

The *Groves* decision highlights a common approach that is proposed by purchasers, but is clearly offside the ESA. If the purchaser wanted to reset Mr. Grove's service under the ESA, there had to be a break of thirteen weeks or more between the two periods of employment.[4] Even then, the purchaser would still be responsible for the previous service when it comes to determining the entitlement to (and amount of) severance pay be owed upon a dismissal without cause.

There are ways that a purchaser can limit its liability for the previous service an employee had with the vendor, but the purchaser must always ensure that it is complying with the ESA with respect to an employee's continuous service.

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[1] *Groves v UTS Consultants Inc*, 2020 ONCA 630 [*Groves*]

[2] Evidence in support of this finding included a clause in the SPA that "no employees intend to leave the employ of UTS as a result of the transaction contemplated." Groves, 2019 at para 49.

[3] Section 5(1) of the *ESA*

[4] See section 9(2) of the ESA and section 8(2) of O.Reg 288/01 of the ESA.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.