

3 Ways to Transition Employment Contracts on Transfer of a Business

Employees are often described as an organization's most valuable asset. But unlike other assets, employees' personal services cannot simply be assigned to a new employer without the consent of both employee and new employer. Accordingly, a transfer of business resulting in the change of the employer's legal identity constitutes an effective termination of employment in the form of a constructive dismissal. Businesses should actively manage how the transfer of employees occurs with a mind to reducing their liability. There are several options that allow a business to mitigate against this risk and ensure a smooth transfer for its employees, including:



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1. Assignment of contract;
2. Termination anticipating employee mitigation by offer of new employment; and
3. Novation of employment contract and offer of new employment.

Assignment of contract

Courts have accepted the assignment of an employment contract by a parent company to a subsidiary company in cases where the employee assents. An assignment means the transferee (the company acquiring the business who we'll refer to as the "buyer") takes on the employees on the same terms as their current contracts, which continue to operate without interruption.

The benefit is if the employee accepts the assignment, they cannot later claim constructive dismissal. The termination provisions, as well as all other terms of the contract which may be favourable to the buyer, will continue in place.

Except in extremely clear cases, courts will not infer an employee's consent to a transfer of employment, so best practice is to have the parties sign a tri-partite agreement to that effect. This agreement should clearly state that the employee accepts the assignment of their contract to the buyer and releases the transferor (the company transferring the business, who we'll refer to as the "seller") from all obligations under the contract.

Termination anticipating employee mitigation by offer of new employment

The most appropriate method when selling a business to an unrelated company is for the seller to terminate all employees and the buyer to offer new contracts to employees on substantially similar terms.

In this scenario, the new employment with the buyer does not, on its own, end the seller's obligation arising from the constructive dismissal. However, employees who start employment with the buyer right away and on substantially similar terms to their employment with the seller significantly mitigate any potential damages caused by the dismissal.

Employees may still experience some loss, for example, if the new terms of employment are not as favourable, or if their new employment is terminated before what would have been the duration of the notice period owed by the seller. In those cases, the seller may remain liable for the unmitigated portion of the employees' losses. The buyer may also be liable for outstanding damages not paid out by the seller. Businesses considering this method should do a careful review of all terms of employment and potential

liabilities and agree to appropriate indemnification clauses prior to the transfer.

Novation of employment contract and offer of new employment

“Novation of contract” means that the obligations between the parties have come to an end. It creates more certainty than simply assuming an employee will fully mitigate their damages. It is described by the Supreme Court of Canada as “a trilateral agreement by which an existing contract is extinguished and a new one is brought into being in its place.”

There are several factors that indicate the novation of a contract. A strong factor is when the new offer of employment from the buyer states that accepting employment with the buyer indicates agreement to a complete discharge of the old obligations in substitution of the new contract. Another indicator is where the seller paid the employee their contractual termination notice (or reasonable common-law notice) in exchange for a release indicating all obligations under the old contract were satisfied.

Key takeaways for employers in Canada

Businesses should take time to clearly define when and how employee contracts will be dealt with during a transfer. The method of transitioning employees to their new company and the resulting apportionment of liabilities should be explicitly set down in an agreement between the seller and buyer.

Questions? Contact Us

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