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EMPLOYEE PROTECTION IN MERGERS AND ACQUISITIONS

BY

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I declare that I have read and understood the regulations governing the submission of master of laws degree dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Signed Signed by candidate **Dated** 06/06/08....

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PREFACE

The acquisition of companies by means of takeovers, or transfers is a frequent occurrence in modern industrialised world. The process of takeover of one company by another, or of amalgamation of one company with another or of merger of one company into group of companies may take place in a variety of specific transactions. However, the law of the individual employment contract has received little attention in these circumstances.

Failure to take the human factor into account may result in failure of the merger or acquisition. Teams are usually put together to oversee merger or acquisition operations. These teams almost always comprise specialists in legal and financial issues as well as experts in strategy but rarely do they include human resource experts. One possible explanation is the fact that speed is generally considered of capital importance for success. While the integration phase of merging enterprises may cover between three to five years, the first few months after the announcement of the transaction are the most crucial for success or failure. It has become common practice to prepare and communicate to staff a program of integration activities to cover this period, when the feelings of fear, apathy and demotivation are at their highest. Since a majority of mergers end up with the elimination of overlapping functions and positions, the first few months are likely to be those when staff are most uncertain about jobs, career prospects and the disappearance of their own corporate culture.

To reduce the possibilities of failure in mergers and acquisitions, it is recommended that human capital be placed at the centre of the process or at least be given equal attention to that assigned to economic and financial considerations. While these

transactions are going on it is important to protect employees by maintaining them in the legal position they would have enjoyed had no change of ownership by way of mergers or takeovers occurred. Various problems arise in the event of these occurrences and although they are labour law related, we shall examine them from the company law point of view, the reason being that employee protection in case of such transactions should be taken as an integral part of the transaction. It is impossible to conclude a merger or an acquisition without dealing with the issue of employees.

What is the acquiring enterprise entitled or obliged to do in so far as the employees of the acquired enterprise is concerned? What is the legal position of the acquired enterprise employees and are they entitled to claim continued employment? What acquired rights are safeguarded in case employment continues? Is the contract of employment capable of being transferred to the acquiring party? Has the acquiring enterprise the right to reject employees of the acquired enterprise? This paper seeks to examine the above raised questions and determine whether adequate protection is given to employees in mergers and acquisition.

In the first chapter, we shall examine business transactions that may constitute a merger or an acquisition; we shall also look at the nature of a contract of employment.

In the second chapter, we shall look at the common law position on the impact of business transfers on employment contracts, and developments in Europe and South Africa.

The third chapter is the main focus of this discussion where we shall examine the applicability of section 197 of the South African Labour Relations Act on employee protection in mergers and acquisitions.

In the fourth chapter, we shall examine available remedies to employees and agreements in terms of section 197 (7) of the Act.

Finally, we shall consider short comings identified in the South African system and offer suggestions on how to improve or remedy the system based on lessons learned from foreign jurisdictions.

Chapter 1

1.0 INTRODUCTION TO MERGERS AND ACQUISITIONS AND THE CONTRACT OF EMPLOYMENT

Merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of their long term profitability. Usually mergers occur in a consensual (occurring by mutual consent) setting where executives from the target company help those from the purchaser in a due diligence process to ensure that the deal is beneficial to both parties.[1] Acquisitions can also happen through a hostile takeover by purchasing the majority of the outstanding shares of a company in the open market against the wishes of the target's board.

Corporate mergers may be aimed at reducing market competition, cutting costs, reducing taxes, removing management by the acquiring managers or other purposes which may or may not be consistent with public policy or public welfare. Thus they can be heavily regulated for example, in Zambia requiring approval by the Competition Commission. In the United States, it requires approval by both the Federal Trade Commission and the Department of Justice.

1.1 What is a merger?

A merger occurs when two companies combine (assets) to form a single company. A merger is very similar to an acquisition or takeover, except that in the case of a merger existing stockholders of both companies involved retain a shared interest in the new company. By contrast, in an acquisition one company purchases a bulk of a second company's stock creating an uneven balance of ownership in the new combined company.[2]

A merger may be sought for a number of reasons, some of which are beneficial to the shareholders, some of which are not. One use of a merger, for example, is to combine a very profitable company with a losing company in order to use the losses as a tax write

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[1] Michael A. Hilt, J.S Harrison, R.D Ireland "***Mergers& Acquisitions: A Guide to creating value for Stakeholders***. Oxford University Press (2001) at p. 54

[2] Michael A. Hilt, J.S Harrison, R.D Ireland at p.59

off to offset the profits, while expanding the corporation as a whole. Increasing one's market share is another major use of the merger, particularly amongst large corporations.

By merging with major competitors, a company can come to dominate the market they compete in, giving them a freer hand with regard to pricing and buyer incentives.[3] This form of merger may cause problems when two dominating companies merge, as it may trigger litigation regarding monopoly laws. Another type of popular merger brings together two companies that make different, but complimentary products. This may also involve purchasing a company which controls an asset your company utilizes somewhere in its supply chain.

Major manufacturers buying out a warehousing chain in order to save on warehousing costs, as well as making a profit directly from the purchased business, is a good example of this. The completion of a merger does not ensure the success of the resulting organisation; some mergers may result in a net loss of value due to problems. Correcting problems caused by incompatibility, whether of technology, equipment or corporate culture, diverts resources away from new investment, and these problems may be exacerbated by inadequate research or by concealment of losses or liabilities by one of the partners.

Overlapping subsidiaries or redundant staff may be allowed to continue, creating inefficiency, and conversely the new management may cut too many operations or personnel, losing expertise and disrupting culture. These problems are similar to those encountered in takeovers. For the merger not to be considered a failure, it must increase shareholder value faster than if the companies were separate, or prevent the deterioration of shareholder value more than if the companies were separate.

1.2 What is an acquisition?

An acquisition, also known as a takeover, is the buying of one company (the target) by another. Acquisition usually refers to a purchase of a smaller firm by a larger one. Sometimes however, a smaller firm will acquire management control of a larger established company and keep its name for the combined entity. This is known as reverse

[3] Timothy J. Galpin, M. Hendon ***"The complete Guide to Mergers &Acquisitions***: Process tools to support M&A Integration at every level. (2000) at p.37

takeover. An acquisition may be friendly or hostile. A friendly takeover, as opposed to a hostile one, is a bid that is recommended to the shareholders by the directors of the company being bought.

Although it is common for the directors of the target of a bid to go to great lengths to oppose it, there are a number of reasons why they may recommend one. They are honestly trying to fulfill their duty to the shareholders, they will be offered positions on the board of the combined company, a takeover is inevitable and the directors prefer this particular one or major shareholders back the bid, so there is little point opposing it.[4]

The recommendation of a bid is usually motivated by several of these motives. A hostile takeover is one that is made despite the opposition to it expressed by the directors of the target company. There are a number of ways in which the directors of the target company may attempt to block the takeover, beyond simply advising shareholders against it.

a) Poison pill

A poison pill is an attempt to discourage an acquisition by making it more expensive to acquire a company, or by reducing the value of the acquired business.[5] A poison pill relies on setting up an essentially destructive mechanism that would be triggered by a takeover, or by an event likely to be linked to a takeover, for example, triggered by the purchase of certain proportion of shares by any one person.

These mechanisms include issuing convertibles, with below market exercise prices, whose conversion is triggered by a takeover, making employees and directors share options, (that would normally be exercisable in the future) immediately exercisable on a takeover or having agreements with customers that include compensation in the event of a take over.

Poison pills are largely designed to protect directors, and are harmful to shareholders. They are designed to deny them the opportunity of selling to an acquirer, usually at a significant premium to the price without bid interest.

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[4] Thomas L. Legare. "***The Human side of Mergers and Acquisitions: Understanding and Managing Human Resource Integration issues***. "Human Resource Planning Journal, vol 21, 1998 at p.17

[5] C. Sundaramuthy, J.M Mahoney, JT Mahoney, ***"Board structure, Ant takeover Provisions and Stockholder Wealth***" Strategic Management Journal vol.18 No.3 at p.235

b) White knight

A white knight is a bidder who makes an agreed takeover bid as an alternative to a hostile takeover bid that is already in progress.[6]

There are a number of reasons why the directors of the target company may prefer the white knight. It may be that the white knight offers a better deal for shareholders. It may also be that the white knight offers a better deal to the directors. While directors have a legal duty to make recommendations on the basis of shareholder's interests, there are often clear conflicts of interest when takeovers occur.

c) Market Capitalisation

Market capitalisation (market cap) is the total value of the shares of a company, sector or market. If a company has only one type of share its market cap is simply the share price multiplied by the number of shares. If a company has more than one class of shares then the market cap is the sum of the market caps of the different types of shares. In either case, it is the value of the company at current share prices, or alternatively the cost of buying the company at current prices.[7]

Therefore, the target company may increase its market cap by making acquisitions of its own, paid for by issuing new shares. As said earlier, hostile bids often reveal a serious conflict between shareholders and directors. Shareholders are offered a chance to sell their shares, usually at substantially above the market price prior to the bid. Directors stand to lose their jobs. In theory, directors should recommend a bid unless they have a good chance of getting a better offer, or have very good reason to believe that the market is under valuing their company.

How impartial decision directors will realistically make is obviously questionable. Some people have argued that one of the key reasons for the occurrence of hostile bids is that they offer a way in which to replace incompetent but well entrenched management.

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[6] C. Sundaramuthy J.M Mahoney, J.T
[7] C. Sundaramuthy J.M Mahoney at p.241

This is because institutional shareholders rarely vote against incumbent management, making it hard to replace the directors even if they under perform.

2.0 The contract of employment

2.1 Nature of contract of employment

An employee is an individual who has entered into or works under a contract with an employer, whether the contract is expressed or implied, oral or in writing.[8] A contract of employment or service is an individual contract between the employer and employee that regulates their symbiotic relationship. Legally it is the most important document from which the rights and duties of the employer and employee are derived. Whatever the circumstances under which a person is employed, they will invariably constitute a contract.

Thus it does not matter that the contract is not written. However from the practical point of view of clarifying what has been agreed upon should a dispute later arise, it is preferable and advisable to reduce a contract of employment into writing. Any contract whether written or oral will consist of at least three separate elements:

a) Any express terms which may have been agreed upon between the employer and the employee.
b) Terms which are implied by common law such as the implied duties of good faith and confidentiality which every employee owes to his employer; the implied undertaking by an employee holding himself out as being skilled, that he will exercise reasonable skill or competence;[9] the implied term that the employer will pay reasonable remuneration for services rendered; the implied right by either party to terminate the contract of employment on notice.
c) Terms that are imposed by statute.[10]

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[8] HALSBURY'S LAWS OF ENGLAND, 16 (4th Ed.) at 13.
[9] See the case of Agholor v. Cheesebrough ponds (Zambia) limited. [1976] ZR 1 {HC} in chapter IV, Infra, which deals with discipline and loss of employment
[10] It should be noted that terms of employment could also be imputed into the contract through collective Unions.

2.2 A contract of employment as personal to the parties

In South Africa, as in most European jurisdictions, employment law has been greatly influenced by the notion that a contract of employment is a personal contract that exists between employer and employee. One of the cases most frequently referred to in this context is *Nokes v Doncaster Amalgamated Collieries* Ltd[11]. The classical liberal view of the employment relationship is summed up in the frequent cited assertion by Lord Artkin, in *Nokes v Doncaster*, that the right to choose one's employer is "the main difference between a servant and a serf". The decision in *Nokes v Doncaster* articulated the notion, central to common law conceptions of employment, that the employee is obliged to render services personally. At the same time, it asserted the importance of the (contractual) freedom enjoyed by the individual employee.

The personal nature of employment contracts re-enforced the principle that an employee as much as an employer was free to choose with whom to contract. In the United Kingdom, the personal nature of the employment contract gave rise to the rule against an order for specific performance of an employment contract. The only remedy available to an employee wrongfully dismissed was an action for damages.[12]

In other European countries similar principles applied.[13] The employment contract

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[11] (1940) AC 1014

[12] Chris Todd "***Business transfers and employment rights in South Africa.***" (2004) at p. 10

[13] "I confess it appears to me astonishing that, apart from overriding questions of public welfare, power Should be given to a court or any one else to transfer a man without his knowledge, and possibly against His will, from the service of one person to the service of another. I had fancied that ingrained in the Personal status of a citizen under our laws was the right to choose for himself whom he would serve, and That this right of choice constituted the main difference between a servant and a serf' (Lord Artkin at 1026).

was founded on mutual consent between employer and employee. The obligation of the employee to perform personally the tasks agreed upon was an essential element to the employment contract.[14] The employment contract was considered to establish a relationship between the employer and the employee that could not be altered by unilateral decision or act of the employer. The consent of the employee was required for any alteration to the terms of the contract.[15]

In South Africa the law concerning contracts of employment has, relatively recently and to a limited extent, recognised the absence of strongly personal characteristics in the majority of employment relationships. The rule or practice against orders for specific performance of employment contracts, imported from English law and founded on recognition of the personal nature of employment relationship was finally done away with in 1982. The Labour Relations Act now establishes reinstatement as the primary remedy for unfair dismissal.

In *Board of Executives Ltd v McCafferty*[16] Supreme Court of Appeal found, in a different context, that an employee was employed by holding company of a "group" of companies despite not having any express contractual arrangements to that effect. The holding company was "at least" a co-employer, it could terminate employee's employment within the group". The essence of the decision was a finding of fact that McCafferty was employed by more than one legal entity within a group of companies at the same time.

Nevertheless, the decision still stands as an example of the increasing willingness of the courts to accept that modern employment relationship may exist without formal contractual arrangements being concluded between a single clearly identified employer with whom the employee has a personal relationship. There are circumstances in which workers may assert a material interest in the identity of owners of the entity for which they work. This may arise where workers have doubts about ability of a new owner of the business to meet the obligations that the employer has under employment contract, or to provide the same degree of job security as the previous owner.

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[14] This rule (or, perhaps, practice) was adopted by South Africa courts and its influence persisted until the Decision in National Union of Textile Workers v Stag Packings (Pty) Ltd (1982) 3 ILJ 285 (T), 1982 (4) SA 151 (T).

[15] On European employment law generally, see Barnard EC Employment Law; Blanpain European Law Kluwer, 2000.

[16] 2000 (1) SA 848 (SCA).

The considerations have occasionally given rise to an objection on the part of workers to a changed ownership of their employer. The principle in *Nokes v Doncaster* does not offer any choice to workers where a change of ownership takes place by a way of a transfer of shares in an employing entity. Where this occurs, there is no change in the legal identity of the employer, whatever the workers may think of the new owners. Nor is there any change in the legal identity of the employer where the owners introduce new management personnel or management structures.

Whether what changes hands are shares in an employing entity or the entity's business is a matter completely out of the hands of the workers. The form of the transaction is determined usually by the question of what is commercially expedient for the transacting owners or employers. This means that the principle in *Nokes v Doncaster* has the effect that the job security of employees in the context of a business transfer was to a considerable extent dependent on the form of the transaction chosen by the transacting employers. In South Africa, workers dissatisfied with their employment are generally able to resign on notice without breaching their employment contracts.

Furthermore, the enactment of the 1997 Basic Conditions of Employment Act (the BCEA) removed the statutory penalty that had previously existed for a worker who terminated employment without giving the required notice. In these circumstances the principle in *Nokes v Doncaster* has seldom, if ever, been invoked to relieve employees of the discomfort of working for a new employer that they do not like, by contrast, the principle has very frequently been invoked to explain job losses following a business transfer.

In short, the principle has done nothing for the well-being of workers in the context of modern South Africa employment law. Nevertheless, the principle in *Nokes v Doncaster* continued to regulate the effect of business transactions on workers' contracts of employment in South Africa until section 197 of the Labour Relations Act came into effect on 11 November 1996.[17]

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[17] See, e.g., ***Ntuli v Hazelmore Group t/a Musgrave Nursing Home*** (1988) 9 ILJ 709 (IC); NUMSA v Spinmet (Pty) Ltd (1992) 13 ILJ 1459 (LAC) esp. at 1464B – D.

Chapter 2

2.0 IMPACT OF BUSINESS TRANSFERS ON EMPLOYMENT CONTRACTS

2.1 COMMON LAW POSITION

Prior to the coming into effect of the Labour Relations Act, the position on transfer of undertakings was regulated by common law contract principles. The principles offered no job security for an employee of the undertaking who was, on transfer of the undertaking, willing to accept employment with the transferee. As in New Zealand the transferor would simply terminate employment on grounds of redundancy – there would not be work for the employee to do. In order to be lawful, required notice of termination of employment must be given.

Furthermore the Industrial Court added to the transferor's obligations. In *kebeni v Cementile Products (Ciskei) Ltd*[18] the court held that, in addition to adequate notice of termination and timeous consultation with the employees' bargaining agents, safeguards should be incorporated to ensure protection of the interests of the work force. This could amount to an agreement between the transferor and transferee that all existing contracts of employment be transferred to the transferee.

This is, however merely a possible scenario and will be determined by the specific factors at play in that instance. The court did not thereby give employees the right of continued employment on transfer of the undertaking. In *Ntuli & Others v Hazelmore Group t/a Musgrave Nursing Home*[19] the court held that the transferor also had a duty to attempt to involve the transferee in the consultation process prior to the transfer and retrenchments. Again, these guidelines did not grant employees the right to be taken into employment by the transferee.

If the transferee planned to transfer the entire undertaking, inclusive of the employment contracts and the related obligations, a mere cession would not have sufficed; a combined cession and delegation of employment contracts would have been

[18] (1987) 8 ILJ 442 (IC)
[19] (1988) 9 ILJ 709 (IC)

required.[20] The consent of all three parties – transferor, transferee and employee – would be required, and effectively constitutes ending the old employment contract and substituting it with a fresh one between transferee and employee.

Except for accrued leave benefits, which were governed by the Basic Conditions of Employment Act,[21] other benefits that arise from duration of service could be adversely affected by such an arrangement. Although there was little common law protection for the employee who stood to loose their job but was willing to accept employment with the transferee, there was strong protection of the employ's right to *not* accept employment with the transferee.

Common law renders contractual rights personal in character to such a degree that they are deemed intransferable – unenforceable by cessionary – unless the contract debtor consents to the transfer.[22] The employer therefore needs the employee's consent for a valid transfer of employment contract. This protection of the employee's freedom to choose by whom to be employed was restated in the case of *Nokes v Doncaster Amalgamated Collieries*[23] where the English Court of Appeal held that this freedom to choose your employer constitutes the *main difference between a servant and a serf.*

2.2 Developments in Europe

Owing to the social consequences for workers of the on going economic integration of the European Community and its member states, the European Council adopted a resolution in 1974 with the objective, among others of increasing the involvement of the workers or their representatives in the life of undertakings in the community.[24] In 1975, the first legislative step was taken: the Directive on Collective Redundancies. The next step was the adoption of the "Transfer of Undertakings" Directive of 1977. This was followed by the "Insolvency Directive of 1980.[25]

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[20] B Jordan 'Transfer, Closure and Insolvency of Undertakings' (1991) ILJ 937
[21] Act 3 of 1983, s12
[22] East Rand Expansion Co v Nel 1903 TS 42 at 53
[23] [1940] AC 1014
[24] Council Resolution 21 January, 1974 (74 / C13 / 01)
[25] See generally Jeff Kenner, EU, Employment Law From Rome to Amsterdam and Beyond, Oxford and Portland, Oregon, 2003 ch.2;

The legislative steps were also understood to be a response to the flood of mergers and the restructuring of mainly large multinational enterprises that was taking place during that period. The objectives of these directives were both economic and social. An economic point of view, they were considered to contribute to facilitate the establishment of enterprises in other member states, and to improve the competitiveness of European firms.

At the same time, the European Council was concerned about the serious consequences of these mergers for employees; the loss of jobs and the loss of employment rights following a transfer from one enterprise to another. The Directive on the transfer of enterprises had a dual purpose. The first purpose was the protection of the rights of workers against adverse consequences of a transfer. In effect, the Directive provided for the automatic transfer of employees in the event of a business transfer.

The second purpose was to impose an obligation on both transferor and transferee to recognise and to observe the right of worker representatives to be involved in the decision making process. This gave rise to the requirement that employers give specified information to workers in good time before a transfer is carried out or before the transfer affects workers.[26]

In compliance with their obligations under the EC Treaty, each European Country has given effect to the provisions of the directive to the extent necessary by appropriate amendments to national laws. In the UK, the applicable national legislation is the Transfer of Undertakings (Protection of Employment) Regulations Commonly referred to as TUPE Regulations.

2.2.1 TUPE Regulations

TUPE, the Transfer of Undertakings (Protection of Employment) Regulations, is a complex area of employment law covering business transfers. It provides protection for employees if their employer transfers responsibility for part of its business to another organisation. TUPE ensures that the members of staff who work in that business will

[26] See art 7 of the present Council Directive (2001 /23 / EC)

automatically transfer to the successor organization and that their rights, including continuity of service, will be protected.

The Tupe regulations of 1981 have recently been replaced by a new set of regulations – TUPE 2006 – which came fully into force on 6th April 2006. These new regulations extend the protection afforded to transferring employees and also address certain issues which have an impact on data protection.

2.2.2 When does TUPE apply?

TUPE will apply to what are known as "relevant transfers', which may occur in a wide range of situations. The two broad categories are:

- The disposal of the whole or part of a business – a business transfer.
- The outsourcing of services currently undertaken by the business – a service provision change.

A business transfer (type one) covers the transfer of any UK undertaking or business or part of it, which could be considered to be an identifiable unit with a specific role or function. So, for example a DIY chain might decide that it no longer wants to have a store which sells only plants and flowers, so it sells that part of its business to a local garden centre. Alternatively, a department store might decide to transfer its household furniture business to a sister company in its group. Both of these situations would be TUPE transfers.

TUPE does not apply where the shares in a company are sold. The employees remain employed by the same company in the case of a share sale. Type 2 transfers may be more common due to the popularity of outsourcing. This type of transfer includes not only the original outsourcing to the first service provider, but also subsequent changes.

2.3 Developments in South Africa

As earlier discussed[27] the Industrial Court in South Africa had adopted the view that it was not necessary or inherent in the right to fair labour practices that a new owner of a business was compelled to take on the employees of the old employer. The court reiterated that the old employer was entitled to dismiss only if there was a fair reason to do so and following a fair procedure, and also restated the extent of the legal duty to pay severance pay where employees lost their jobs on the grounds of their redundancy.

The court considered that these statutory protections provided adequate employment security to workers affected by business transfers, and that the right to fair labour practices did not require further protection in the form of guaranteed continuity of employment following the transfer. Interpreted in this way, the right to fair labour practices had the consequence of limiting the seller's rights by imposing an obligation to terminate employment contracts fairly.

But it did not in anyway limit the rights of the buyer, who could still dictate the terms of the transactions insofar as it affected employees engaged in the business being transferred. Section 197 came into effect on 11 November 1996, along with the material provisions of the 1995 LRA. Its meaning and effect, however, produced considerable disagreement among commentators and the labour courts alike.

In some cases, the labour courts considered the provision to have similar effect to the EC Directive, and to provide for the automatic transfer of contracts of employment in the event of a business transfer.[28] In *NEHAWU v University of Cape Town* both the Labour Court and Labour Appeal Court disagreed with this interpretation of the section and considered that the section did not change the common law contractual position.

The Labour Appeal Court[29] concluded that there was no obligation on the new owner of a business to take on the employees of the old employer unless this was agreed between the two transacting employers. This was not, however, the final word. *Nehawu*

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[27] In Ntuli & others v Hazelmore Group (1987)

[28] Schutte & others v Powerplus Performance (Pty) Ltd & another [1999] 2 BLLR 169 (LC); Foodgro (A division of Leisurenet Ltd) v Keil [1999] 9 BLLR 875 (LAC).

[29] In NEHAWU v University of Cape Town [2002] 4 BLLR 311 (LAC) (overruled by the Constitutional Court on appeal).

took the matter on appeal to the Constitutional Court. The Constitutional Court[30] disagreed with the Labour Court's interpretation of section 197. The Constitutional Court found that section 197 had the dual purpose of facilitating commercial transactions while at the same time protecting workers against unfair job losses.

The court held that the majority in the labour Appeal Court had failed to take sufficient account of one of these purposes, namely protecting workers against loss of employment in the event of the transfer of a going concern. The court found that section 197, properly interpreted, gave rise to an automatic transfer of employment contracts from the transferor to the transferee of a going concern.

[30] NEHAWU v University of Cape Town (2003) 24 ILJ 95 (CC).

Chapter 3

3.0 APPLICABILITY OF SECTION 197 (LRA) ON TRANSFER OF UNDERTAKINGS

The Labour Relations Act No. 66 of 1995, (LRA) implemented on 11th November 1996, is the instrument that transformed the South African Labour law regime. Wide consultation went into the drafting of the original Bill that was submitted to the National Economic Development and Labour Council[31] (Nedlac) and into the subsequent redrafting process that resulted in the final product. Not unlike the dynamics at works in drafting EEC Directives, the negotiated character of the LRA has led to some problems.

Compromise may lead to the situation of a provision being left suspended, a fusion of different ideas, leaving it neither "here nor there". A detailed study of section 197 of the LRA, which follows below, leaves one with the impression that this provision, could have suffered from this compromise dynamic. The main purpose of the legislature was to introduce a provision which would give employees greater job security and protect their accrued rights. It was also deemed necessary to make it easier for employers to shift employees from the transferor to the transferee, thus facilitating business transfers.

Guidance was sought from Europe as to what the contents of the provision should be. This was reflected in the similarities between section 197 introduced in the Labour Relations Act, the United Kingdom's Transfer of Undertakings (Protection of Employees) Regulations (TUPE) and European Parliament's Acquired Rights Directive 77/187. The provisions of section 197, prior to their amendment in 2002 created a great deal of confusion around its proper interpretation.

The Explanatory Memorandum accompanying the Draft Labour Relations Bill stated that the section made provision, "for the automatic transfer of contracts of employment to the transferee provided the employees consented to the transfer." The wording of the provision eventually adopted by the legislature did not clearly establish that position. On one reading, when business were transferred as going concerns, section

197(1), while initially re- affirming the Common Law Prohibition on transferring contracts of employment without the employee's consent created an exception to the general principle.

Thus taking section 197 (1) with subsection (2), whenever a business was, objectively determined, transferred as a going concern the bundle of contracts, rights and obligations would transfer automatically to the new employer.[32] The Consent of the employers to the transfer of the relevant employees was also not required. There was nothing in the wording of the section which clearly initiated against such an interpretation and it received endorsement, albeit *Obiter,* from the Labour Appeal Court in *Foodgro (a division of Leisurenet ltd) v Keil.*[33]

A third interpretation of section 197 found favor with the Labour Court and Labour Appeal Court in the matter of *Nehawu v University of Cape Town.*[34] The majority of the Labour Appeal Court adopted what might be termed a commercial or corporate approach to interpreting section 197, in the process rejecting the views expressed by the Court in the *Foodgro* decision. In *Nehawu* the Labour Appeal Court stated that "the key to the interpretation of the section is.....the fact that the section deals with transfer of contracts without the consent of employees and is silent about the agreement of employers interse".[35]

That silence in section 197 (1) was taken as an indication that the legislature did not intend to do away with the requirements of employer consent. This was bolstered by the fact that the phrase "transfer as a going concern" traditionally suggests an agreement between the employers as to what is transferred and will necessarily include the transfer of the labour force. In the Courts view, an entity could not be transferred as a going concern unless all or most of the workforce were transferred.

The final decision in *Nehawu and the University of Cape Town* came from the Constitutional Court. The court emphasized that the LRA has to be purposively construed so as to give effect to the constitution, in particular the right to fair labour practices. The

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[31] Government Gazette No. 16259 56, 141
[32] *Schutle & Others v Powerplus Performance Ltd* (1999) 20 ILJ 655 (LC) at 664
[33] (1999) LAC at 99
[34] *Nehawa* at Para 36

concept of fair labour practices requires a proper balancing of the competing interests of employees and employers.

In the courts' view section 197 has a dual purpose. It is clearly intended to protect employment security and employment rights. That much is apparent from the foreign provisions on which section 197 is based and the fact that the section forms part of the chapter of the LRA promoting employment security. On the other hand, section 197 is also intended to facilitate business transfers.

It permits the transfer of employment contracts from one employer to another without employees having to be retrenched and new contracts of employment concluded, and no severance pay need to be paid by the transferor employer. The constitutional court found fault with the decision of the Labour Appeal Court on two grounds. First, the phrase "going concern" had been incorrectly interpreted. The meaning attached to that term by the Constitutional Court will be discussed in more detail below.

Second, the approach advocated by the Labour Appeal Court did not take sufficient account of the worker protection function of section 197, effectively making section 197 a voluntary obligation. The correct interpretation of section 197 was that when there was, objectively speaking, the transfers of a business as a going concern, workers were automatically transferred to the transferee. The Court did not express a view as to whether the affected workers could object to their transfer to a new employer.[36]

Prior to the Constitutional Courts' decision in *Nehawu v UCT,* the legislature had adopted amendments to section 197, clarifying when it would be applicable and what the effects of its application would be. We shall now concentrate on analysing section 197 after the 2002 amendments though reference will be made to the section prior to its amendment and the decisions under those provisions to the extent that they illuminate the problems which necessitated the amendment.

Section 197 (1) provides that the section will apply when a business is transferred from one employer (the old employer) to another employer (the new employer) as a going concern. This provision is rather complicated though it seems simple. The question

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[35] *Nehawu* at Para 37 – 38
[36] Chris Todd, at p.22

of whether or not section 197 applies to a particular transaction and thus whether employers are bound by its provisions is recipe for litigation.

This is largely because the requirements for the application of section 197 are not precisely stated but rather broadly stated. The Courts have thus been charged with giving content to the terms contained in section 197 (1). However, judging from what has hitherto emerged from the courts, they will often be uncertainty as to whether a particular transaction will be covered by section 197.[37]

Section 197(1) has three components. First, the relevant transaction must be a "transfer" envisaged by section 197. Second, the entity being transferred must be a business or part of a business and third, the business must be transferred as "a going concern". Should any of these be lacking, section 197 will not apply and regard must be had to the common Law, applied in light of the right to fair labour practices. Each of these phrases will be examined in turn to determine the overall scope and application of the section.

3.1 What constitutes a transfer?

The first thing to consider is when a transfer as contemplated under the statutory provision has taken place. The common form of transfer of property such as a business is by sale, but it is clear that section 197 would easily be circumvented if its operation was restricted to the sale transaction hence the use of the term "transfer". The court in *Schutte & others v Powerplus Performance (Pty) Ltd & another,*[38] noted that there is a wide range of transactions in terms of which a business may be transferred ie sale, transfer, merger, takeover, donation , exchange of assets, and that section 197 need not be limited in its application to conventional transferring transactions like sale.

The courts have also stressed that in determining whether section 197 applies, regard must be had to the substance and not the form of the relevant transaction.[39] Such

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[37] Chris Todd, Supra at p.24
[38] (1999) 20 ILJ (LC)
[39] *Nehawu*.....at Para 56;Schutle at Para 42; *Fourie & another v Iscor Ltd* (2000) 11 BLLR 1269 (LC)

an approach prevents employers from resorting to devices to avoid the application of the section in order to deprive employees of the protections conferred by section197. We now have to discuss particular kind of transfer and assess whether there has been a particular kind of transferring transaction in order for section 197 to apply.

3.1.1 Outsourcing or Contracting -Out

Outsourcing occurs when an employer, rather than employ its own personnel, contracts with a service provider to take over a particular function in its enterprise. This may involve core or non- core activities. A typical scenario is what happens to employees when their functions are outsourced? Company P conducts a manufacturing business from premises in Durban where it makes air conditioners. These air conditioners are packed and distributed from a warehouse on the same premises as the factory.

Company P decides that it can achieve savings by outsourcing some of the non-core functions currently performed by its own employees. One such function is security. It enters into discussions with a security company and establishes that the security company can provide the service at a lower cost. It would be prepared to consider offering Jobs to some of company P's employees but on its terms and conditions (which are less favorable).They would also have to start as new employees. Do these employees have any rights?

According to a recent decision of the Labour Appeal Court in *Samwu & Others v Rand Airport Management Company*,[40] they do. In that case the court was forced with similar facts. Rand Airport wanted to outsource security and gardening. The union argued that this outsourcing exercise was covered by the provisions of section 197 of the Labour Relations Act, that the company was transferring part of its business as a going concern, and that the employment contracts of the employees performing those functions therefore transferred automatically to the service provider on their existing terms and conditions.

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[40] (2005) 3 BLLR 241 (LAC)

Although the union lost on the facts in the Rand Airport case, the decision is of great importance to anyone considering outsourcing, as it confirms the following important principles:

- The wording of section 197 of the LRA since it was amended in 2002 to include the concept of "service" within the definition of "business" means outsourcing arrangements can fall within the application of section 197.
- In considering whether section 197 applies (that is whether there has been a going concern transfer) each case will be determined on its facts. The intention of the parties will not be determinative. The court will look at the substance rather than the form of the transactions.
- If an outsourcing agreement is implemented which the court determines falls within the ambit of section197 then the employment contracts of all these employees who previously performed the functions which are outsourced will transfer to the service provider on the prevailing terms and conditions.

3.1.2 Second generation outsourcing or contracting-out

Second generation outsourcing typically occurs where an employer puts the outsourced service or activity opportunity out to tender upon the outsource contract coming to an end and a new entity is awarded the outsourcing opportunity following the original outsource entity being unsuccessful in its bid to secure the contract for an additional term.[41] Some commentators have asserted that the wording of section 197 precludes its application to second generation contracting-out.[42]

This is because section 197 relates to a transfer by the old employer. In the case of second generation contracting-out the old employer is the outgoing contractor and the new employer the incoming contractor. According to this argument there is no transfer by the old employer to the new employer and second generation contracting out is effectively exempted from the application of section 197. There is also a wealth of

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[41] *Cosawu v zikhetele Trade (Pty) Ltd & another* (2005) 26 ILJ 1056 LC

[42] Grogan "*Outsourcing workers: A fresh look at S. 197* (2000) Employment law 15 at 18

comparative jurisprudence which suggests that section 197 should apply in such situations.

In getting to grips with section 197 of the LRA the courts have repeatedly stated that this section must be given a purposive interpretation. The Constitutional Court has held that the purpose of section 197 of the LRA is to protect the employment of employees and to facilitate the sale of business as going concerns by enabling the new employer to takeover the workers as well as the other assets in certain circumstances. The purpose of section 197 of the LRA is stated as "to facilitate commercial transactions whilst at the same time protecting workers against unfair job losses".[43]What then is the impact of section 197 of LRA upon secondary transfers or second generation outsourcing arrangements?

This question was considered in the recent case of *COSAWU V Zikhetele Trade (Pty) Ltd & Another.*[44] In this case the court was confronted with rather interesting facts. Without dealing in detail with the history of the matter, it will suffice to state that the Fresh Produce Terminals (FPT) at the Cape Town, Port Elizabeth and Durban harbors outsourced the terminal and stevedoring services to outside companies which ultimately became khulisa. The two main players in khulisa were the Managing Director, Mr. Mfundisi and Mr. Immelman the Operations Director.

As a result of an acrimonious dispute between Mfundisi and Immelman, FPT rethought its relationship with Khulisa. It put its terminal and stevedoring contracts out to tender and two new companies tendered for the business, namely Zikhethele run by Mfundisi and a company formed by Immelman, trading as Signal Hill. FPT awarded the outsourcing contract to Zikhethele, where upon Signal Hill launched an urgent application in the court to interdict the implementation of the contract.

In the interim COSAWU wrote a letter to Mfundisi to enquire whether the Khulisa employees were to be retrenched or whether they would transfer in terms of section 197 to Zikhethele. Mfundisi did not provide a candid response, partly possibly, as a result of some of the Khulisa employees supporting Immelman's bid for the contract. On the 1st of April 2005, the day when Zikhethele stepped into the shoes of Khulisa as FPT's service

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[43] *Nehawu v University of Cape Town, Supra*
[44] (2005) (26) ILJ 1056 LC

provider, Mfundisi as Managing Director of Zikhethele informed all Khulisa employees that they were seconded to Zikhethele from the 1st of April.

The purpose of the secondment seems to have been motivated by the fact that the application launched by Immelman's company to undo the outsourcing between FPT and Zikhethele would be heard on the 11th of April 2005. The matter was not heard and on the 26th of April 2005, Mfundisi addressed a second memorandum to Khulisa employees informing them that their secondment would end on the 29th of April 2005. Khulisa employees were invited to apply for positions with Zikhethele if they wished to be employed by Zikhethele which indicated that there would be no automatic transfer of employment from Khulisa to Zikhethele.

On the 26th of April 2005, an application was made to place Khulisa under provisional liquidation, which order was granted on the 5th of May 2005. As it was evident that only those employees of Khulisa who formally applied for positions with Zikhethele would be employed by Zikhethele, COSAWU launched an application in the Labour Court to declare that all the rights and obligations between Khulisa and Khulisa employees not employed by Zikhethele transferred automatically in terms of section 197 of the LRA to Zikhethele when it won the contract to provide the terminal and stevedoring services of FPT.

The court first considered whether a second generation transfer fell within the ambit of the wording of section 197: "Although the matter was not pertinently argued before me, a compelling argument can be made, based on the express language in section 197 of the LRA, that the requirement in s 197(1) (b) that a transfer of business be by one employer to another precludes its application to second generation contracting-out, because in such arrangements nothing is transferred by the old employer to the new employer. Hence, second generation contracting out is effectively exempted from the application of s 197". [45] Whilst the court acknowledged that the express language of section 197 of the LRA might specifically exclude a second generation transfer from the ambit of section 197, it was persuaded to conclude that: ".... a less literal and more purposive approach is justified in the context of section 197. As stated earlier, the section

[45] (2005) 26 ILJ 10561-J LC

is intended to protect employees whose security of employment and rights are in jeopardy as a result of business transfers."

Section 197 applies to a transfer of a business by one employer to another employer. As said earlier on, first generation contracting occurs when the business is transferred from the primary employer to the outsource company (first contractor) and a second generation transfer occurs when the business is transferred from the first contractor to a second contractor. However, it is hardly ever the case that the first contractor will be transferring the business to the second contractor (except in the case of labour brokers).This difficulty was overcome by the court by relying on the *Metsweding District Municipality*,[46] case which held that the lack of a contractual link between the transferor and the transferee is not a necessary precondition for the application of section 197 of the LRA.

The court was persuaded to accept a purposive interpretation of section 197 on account of policy considerations. It held that a literal interpretation of section 197 would result in employees of a first generation contracting out being protected but that second generation transfer employees would be without protection. The court held that the possibility for abuse and circumvention of the protection introduced by section 197 of the LRA existed and that this could be exploited by unscrupulous employers.

The court held that employees affected by second generation outsourcing schemes ought to deserve the same protection as employees under first generation outsourcing schemes. The court considered the UK Court of Appeal decision in *Dines v Initial Services*[47] which constructs a second generation transfer as a two-phased process: the first being the handing back of the service by the first contractor to the primary employer and the second phase being the granting by the primary employer of the service to the second contractor.

As is usually the problem with applying section 197 of the LRA, the decisive issue is whether the business, or for that matter the service, being transferred constitutes the transfer of a business or service as a going concern. European law does not rely on the concept of a going concern to bring transfers within their regulatory framework.

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[46] (2003) 24 ILJ 2179 LC
[47] (1994) IRLR 336

Notwithstanding this, our courts have relied heavily on what constitutes a transfer of a business in European Law to interpret a transfer of a business as a going concern.

When turning to consider what constitutes a transfer of a business as a going concern, the court noted that the South African law echoed the European law in this regard and all that is required is whether: "After the alleged transfer the undertaking has retained its identity, so that employment in the undertaking is continued or resumed in different hands of the transferee."[48]

It is not the mode or method of transfer which is material but to examine all the factors, *inter alia* the identity of the undertaking, the relevant transaction, a comparison between the actual activities and the actual employment situation of the business before and after the alleged transfer, and to determine whether the undertaking is continued in the same or similar manner.

The court reiterated that the factors enumerated by the Constitutional Court will guide the assessment of whether a transfer of a service as a going concern occurred: "A number of factors will be relevant to the question whether a transfer of a business as a going concern has occurred, such as the transfer or otherwise of assets both tangible and intangible, whether or not workers are taken over by the new employer, whether customers are transferred and whether or not the same business is being carried on by the new employer.

What must be stressed is that the list of factors is not exhaustive and that none of them is decisive individually. They must all be considered in the overall assessment and therefore should not be considered in isolation."[49]

The court then turned to consider the facts and circumstances in the *Zikhethele* matter. The court was persuaded that there were significant features present to indicate that there was a transfer of a business as a going concern from Khulisa to Zikhethele. The court found the following factors as instructive in coming to its conclusion: - The history of the outsourcing activities was such that the service provided had remained in almost identical form from the first outsourcing to the present.

- The jobs were done at the same location.

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[48] *Cosawu v Zikhethele*, Supra page 1068 at C-D
[49] *Nehawu v UCT Supra* at page 119 G- 120 B

- The jobs were done by using the same operational methods.
- The same premises, fittings and equipment used by Khulisa were now at the disposal of Zikhethele.
- Some of the suppliers appeared to be the same.

From a policy point of view the court also concluded that a finding adverse to the applicants would leave them not only without continuity of employment, as Khulisa was in the process of being wound-up on account of it not being able to pay its debts, but without severance payment. The court echoed the European law theme that in instances of the transferring businesses it is necessary to view the situation from an employment perspective and not from a perspective conditioned by principles of property, company or insolvency law.

This decision has far reaching consequences for employers who have outsourced certain parts of their business or who intend outsourcing any part of their businesses. The consideration which normally drives outsourcing, namely cost cutting, may not be readily available to businesses any longer as employees would transfer on substantially the same terms and conditions of employment, unless an agreement is reached with the employees to the contrary.

3.2 What Constitutes a Business?

It should be noted from the outset that section 197 will only apply where the entity to be transferred constitutes a 'business" as defined in section 197(1) (a). It is only once the relevant entity is properly delineated that it is possible to determine which employees are connected to that entity and thus likely to be affected by the transfer. Further, the components of the relevant entity are crucial in deciding whether that entity has transferred as a going concern. The entity that is assessed for the purposes of section 197 comprises what the transferor is being divested of by virtue of the transfer.[50]

According to section 197(1) (a) a "business" includes the "whole or a part of any business, trade, undertaking or service." Therefore, for the effects of section 197 to come into place, a business or part thereof will have to be the subject of the transfer. It is the

"part of a business" that provides the difficult issue of interpretation. In *SAMWU and Others v Rand Airport Management* Case,[51] the labour court had to decide whether a garden service which had been outsourced constituted a business in terms of the Act.

The judge on this issue appears to conclude that it was not a business or part of a business primarily because the gardening function forms part of maintenance service. In other words, gardening could not be "part of the Airport Management business because it was part of another part, i.e. maintenance. In addition gardening and maintenance of which it was a part was also non – core activities of the airport. The other issues raised by the judge in this regard, appear to be incidental to the issue of whether a business or part was transferred.

Bosch[52] concludes that this is a very narrow view, one which is not supported by the wording of the Act or the European Court of Justice which describes a relevant entity as "an organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective.[53] Again in the *University of Cape Town* case the labour court in part of its reasoning to exclude the working of section 197 indicated that the outsourced services, although they could be identified as a separate economic entity, did not constitute a business because part of the business as such was retained by *UCT.*

This reasoning appears to be similar to that in *Rand Airport* in that the outsourced services were part of a part and therefore outside section 197. As Bosch concludes, if that was the case the employers could outsource piecemeal and therefore avoid section 197.[54] It falls back to the court to look at the substance rather than the form. When the *Rand Airport Management* case came before the Labour Appeal Court, it focused its attention on the 2002 Amendment[55] which introduced the concept of "service" into the definition of business in section 197(1).

Given the definition of service in the *New Shorter Oxford English Dictionary* and the use of the term service in the draft agreement drawn up between the company and the

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[50] Chris Todd...Supra at 32
[51] Samwa & Others v Rand Airport Management Co.
[52] C. *Bosch Balancing the Act: Fairness and Transfers of Business* (2002) 25 ILJ at 934
[53] Suzan v Zehmacker Gmbh (1997) IRLR 255 at 933
[54] C. Bosch....Supra at 933
[55] Act 12 of 2002

two outsourcing companies, the judge concluded "that both the gardening and security functions fell within the ambit of the word "service" in section 197 of the Act. The functions thereby also were part of a business.

3.3 Employment in the Business being transferred

Once it is established that the entity being transferred constitutes a "business" for the purposes of section 197, it becomes imperative to determine which employees form part of the business being transferred. Only those who are part of the entity being transferred will be affected by the transfer. The number of employees in the entity is also relevant to determining whether the entity has been transferred as a going concern.

3.3.1 Employee at the time of transfer.

An "employee" is defined in section 123 of the LRA as:

a) Any person, excluding an independent contractor, who works for another person or for the state and who receives, or is entitled to receive, any remuneration; and
b) Any other person who in any manner assists in carrying on or conducting the business of an employer, and "employed" and "employment" have meanings corresponding to that of "employee".

The definition of "employee" is potentially very broad, given that it applies to every worker who in any manner assists in carrying on or conducting the employer's business. However, in order to avoid absurd results, our courts have held that any worker who is an independent contractor is not covered by LRA. The distinction to be made in every case is therefore between employees and independent contractors. In many cases the starting point in making the distinction between employees and independent contractors will be the presumption of employment set out in section 200A.

If any one of the factors listed there is present the worker is presumed to be an employee unless the employer can demonstrate the contrary. In the *Transport Fleet*

Maintenance (Pty) Ltd & another v NUMSA & Others,[56] the transferor dismissed certain employees about a month prior to transferring its business as a going concern. The employees successfully contested the fairness of their dismissal in the CCMA and were awarded retrospective reinstatement with the transferor employer.

When they reported for duty they discovered that the business had been transferred, and wanted the transferee to give effect to the CCMA's award on the basis that all the transferor's rights and obligations had transferred to the transferee, including its obligations in relation to their reinstatement. The employers argued that the employees were not employees for the purposes of section 197 because they had been dismissed prior to the transfer of the business as a going concern.

And section 197 could only apply to transfer the employee's rights if they were employees at the time of the transfer. The Labour Appeal Court found that the employment relationship between the employees and the transferor employer had continued beyond the termination of the contract of employment. According to the principle used, the employment relationship will survive the termination of the contract employment.

3.3.2 Employees must be connected to the transferred business

It is often difficult to determine whether an employee is connected to the "business" that is transferred in situations where transfer involves part of an employer's business. One potential problem is where only part of an undertaking or business is transferred and an employee spends some time working in the part that is not going to be transferred. In the matter of *Anderson v Kluwer Publishing Ltd,*[57] the court established a crude benchmark an employee must spend at least 80% of the time working for the transferred unit before the transfer of the employee would be considered.

The European Court of the Justice, in *Botzen v Rotterdamsche Droogdok Matsschappij BV,*[58] held that the employee must be *wholly engaged* in the transferred

[56] (2004) 25 ILJ 787
[57] COIT 15068/85
[58] (1995) IRLR 633

part, with only some allowance for minimal application to other jobs. This does not include employees who perform certain duties which involve the use of assets assigned to the part transferred. In another case,[59] the UK Employment Appeal Tribunal held that the determination of this matter of the employee being part of the transferred part is a question of fact and that there a number of factors relevant to the enquiry: time the employee spends on the relevant part of the business; the value added to that part by the employee; the job description in the employment contract; and the allocation of costs between the different parts of the business.

This flexible approach followed in the UK and elsewhere by EC member States appears sensible and the South African Court should and probably will take note of it when deciding on this matter.

3.3.3 Transfer of a business as a going concern

Case law on the application of section 197 will turn on whether a business has been transferred as a going concern. The leading case on this subject is the decision of the *Constitutional Court in National Education Health & Allied Workers Union v University of Cape Town*[60]. The court said that the phrase "going concern" must be given its ordinary meaning. Thus what is transferred must be a business in operation so that the business remains the same but in different hands.

The test for transfer as a going concern is an objective one. As with most aspects relating to the applicability of section 197, regard must be had to the substance and not the form of the transaction. And in deciding whether the section applies, account must be taken of all the relevant factors in the particular circumstances of the case. *Schutte& Others v Powerplus Performance (Pty) Ltd*[61] is a typical example of when a business might be regarded as having transferred as a going concern.

The employees in that case were employed by Super Rent; a division of Super Group (the second respondent), whose main business was the renting out of motor vehicles. Super group maintained and serviced its own motor vehicles. Its vehicle maintenance

[59] Duncan Webb offset Ltd v Cooper & Others (1995) IRLR 633
[60] Nehawu v UCT Supra

workshops, however, proved unprofitable. Super Group therefore opted to close its workshops and outsource the work to a specialist in the field. In terms of an agreement between Powerplus Performance and (Pty) Ltd and Super Group, the latter would sell its workshops to the former.

The affected employees were informed that the workshops were closing and that they could apply for positions with Powerplus. Applying a test very similar to that set out by the Constitutional Court, the Labour Court found that there had been the transfer of part of a business as a going concern. This was because:

- It was the intention of the employees that the workshop personnel would be transferred to Powerplus and would continue maintaining and servicing Super group's vehicles;
- Certain members of management were transferred to Powerplus;
- The stock and some of the equipment of the workshops was to be taken over;
- Powerplus would use the premises previously used by the Super Group to maintain and service its vehicles; and
- There was no significant interruption between the function performed by Super Group and the subsequent performance by Powerplus.

A number of judgments of the Labour Court have considered these and several of the other factors mentioned by the Constitutional Court in determining whether a business has transferred as a going concern.[62] As the Court points out in the *Schutte* case the phrase "as a going concern" has traditionally been adopted to distinguish the sale of an undertaking from the sale of merely the assets of the undertaking or shares in the business.

This phrase appears in neither Directive 77/187/EEC nor the UK's TUPE. Yet it was included in section 197 to emphasise its specific scope of application. In *Manning v Metro Nissan*[63] the court, dealing with a section 197 transfer, referred to an older Supreme Court decision in which the court held that, in the context of the sale of a business, a business 'as a going concern' is a business that is 'active and operating'.

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[61] Schutte & Others v Powerplus Performance Supra

[62] Fourie & another v Iscor Ltd (2000) 11 BLLR 1269 (LC); Tekwini Security Services CC Mavana (1999)

In the UK, prior to the introduction of TUPE, a 'going concern' test was developed to determine whether there had been a transfer of a business. In *Kenmir v Frizell*[64] the English Court held that the vital consideration to this matter is whether the transferee is put in possession of a going concern, the activities of which can be carried on without interruption. Substance rather than form should be considered to determine this – relevant factors should be weighed, with one single factor rarely being conclusive.

The phrase 'transfer of business/undertaking as a *going concern'* would amount to tautology under Directive 77/187/EEC; the legal position under the directive is that the entity transferred either is a business or it is not – no reference to going concern. There is no middle position whereby some businesses – call them dormant (as opposed to 'as going concern') – do not fall within the scope of the provisions.

The provisions have been given a purposive interpretation to include in its operation (dormant) undertakings which had ceased operations for a period. The prime example is the leading ECJ case of *Spijkers v Gebroeders Benedik Abbatoir CV and Another.* Where the transferor had ceased the business activities of the undertaking before the transfer took place, and the transferee only (re) started the activities after six weeks, and for completely new customers.

In the *NY Molle Kro case*[65] the ECJ also held that, even though the undertaking was regularly closed for part of the year due to seasonal patronage and that the transfer had taken place in this period of closure, this was merely one factor to be considered and not an outright bar on the application of the directive. Where, in weighing up the relevant factors, it is found that the entity being sold does not constitute a 'business' as contemplated under the regulating provision, it constitutes assets – be they tangible or intangible.

Active trading at the time of transfer is not necessary to fall within the operation of the provision. The rational is stated in the Spijkers case:

Though it is plain that a sale may take place simply of the physical assets or part of them with no intention in any real sense that the business should thereafter be carried on, care

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[63] [1968] All ER 414

[64] [1986] (2) CMLR 296

[65] Case 287/86, Landsorganisationen I Danmark for Tjenerforbundet I Danmark v Ny Molle Kro, [1987]

must be taken to ensure that such a sale is not a disguise to avoid obligations to the workers under the Directive.

A case could thus be made for section 197 to rather omit the phrase 'as a going concern' and follow the EC and TUPE approach, referring merely to the transfer of an undertaking/business. In spite of the difference in terminology the court in the *Schutte* case held that the *ECJ and the English courts grappled with the interpretation to be given to the concept of a transfer of a business as a going concern... '[t] heir decisions are useful in guiding this court through uncharted waters.* (Emphasis added).

In the Schutte case the court thus looked at criteria that would bring transfers within the operation of EEC Directive 77/187 in order to help determine whether transfers are such as to have been as a going concern – thus on that level within the operation of section 197.

Chapter 4

4.0 REMEDIES AVAILABLE IN TERMS OF SECTION 197

4.1 INTRODUCTION

As we have seen from the preceding chapter, section 197 may give rise to a wide range of disputes, especially on whether or not a particular transaction is a "transfer of a business as a going concern" for purposes of Labour Relations Act (the LRA). In practice, this question will invariably be linked to further issues in dispute, of which the outcome will depend on whether section 197 is found to be applicable. Typically, such disputes may relate to:

- The dismissal of employees before or after the transaction (in particular, whether such dismissal was automatically unfair in terms of section 187(I) (g) or fair in terms of section 188);
- Whether effect was given to the various requirements of section 197 (for example, whether the terms and conditions offered to employees by the new employer where "on the whole not less favorable" than those offered by the old employer); or
- Whether an employee's resignation following a transfer maybe regarded as "dismissal" in terms of section 186 (I) (f).[66]

It should be noted that there is no special provision in the LRA for resolution of disputes arising from section 197. In terms of section 157 (I) the Labour Court has exclusive Jurisdiction over 'all matters that else where in terms of this Act or in terms of any other laws are *to be determined by the Labour Court*. On a literal reading this would seem to exclude not only disputes concerning section 197, but disputes about all other provisions in respect of which Jurisdiction is not explicitly conferred.

Such an interpretation would clearly be at odds with the purpose of the Act,[67] as well as its long title, which states that the Labour Court is to have exclusive Jurisdiction "to

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[66] Chris Todd, Supra p. 187

[67] S I (d) (iv) includes "the effective resolution of labour disputes" among the "primary objects" of the LRA

decide matters arising from the Act." In *Sappi Fine Papers (Pty) Ltd v PPWAWU & Others*,[68] it held was that in order to give effect to this purpose of the Act, and to enable the objectives of the Act to be fulfilled, the Labour Court must have the power to enforce the provisions of the Act. Therefore, it follows that any dispute concerning the interpretation or application of Section 197 may be adjudicated by the Labour Court. Apart from the Labour Court, the Civil Courts also have concurrent Jurisdiction over "any matter concerning a contract of employment."[69]

4.2 Available Remedies

Most of the applications brought by employees to the courts in South Africa are seeking a declaratory order to the effect that the transaction in question was subject to section 197,[70] combined with appropriate relief premised on the requirements of section 197 such as:

- An order for payment of severance pay to employees retrenched by the new employer in respect of their period of service with old employer;[71] and
- An order for payment of employee benefits due upon termination of their employment with the old employer, not withstanding their transfer to the new employer.[72]

Employers have also applied for interdicts restraining employers from proceeding with business transfers pending compliance with various requirements, including:

- Disclosure of information and renegotiation of the contract of sale of the business in compliance with section 197;[73]
- Consultation with the employee's trade union; [74] and
- Compliance with section 197.[75]

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[68] (1997) 10 BLLR 1373 (SE)
[69] Section 77(3) BCEA
[70] Sacwa v Engen Petroleum (1999) I BLLR 37; Schutle & others v Powerplus Performance Ltd (1999) 2 BLLR 803; Samwa & Others v Rand Airport Management Ltd (2002) 12 BLLR 1220
[71] FAWU V Royal Salt (Pty) Ltd (1997) 4 BLLR 434; Keil v Foodgro (1999) 4 BLLR 345; Fourie & Another v Iscor Ltd (2000) 11 BLLR 1269
[72] Telkom SA Ltd & Others v Blom & Others (2003) 7 BLLR 638 (SCA)
[73] Kgethe & Others v LMK Manufacturing (Pty) Ltd (1997) 10 BLLR 1303
[74] SACTWU v Island view Holdings & another (1998) 4 BLLR 425 (LC)

All the remedies referred to above are competent in terms of the powers of the Labour Court set out in section 158 (I) (a) and (b). The basis for obtaining an interdict is limited, it requires an applicant to establish a clear right or a right *Prima facie* established though open to some doubt, a well grounded apprehension of irreparable harm, a balance of convenience in favor of the granting of interim relief, and the absence of any other satisfactory remedy. Thus in all the cases where an employee party sought an interdict restraining employer parties from proceeding with a business transfer, the application was ultimately unsuccessful because, in essence, the applicants were unable to establish the existence of a *prima facie* right. In *Kgethe v LMR Manufacturing* and *NEHAWU* v *University of Cape Town*, the rights alleged by the applicants depended on the applicability of section 197. In *kgethe* the Labour Appeal Court was unable to establish whether this was the case and consequently refused an interdict, whereas in NEHAWU, it was found that section 197 did not apply.

On the other hand, employees have sought to avoid the application of section 197 in instances where transfer to the intended new employer was perceived as being to their disadvantage, such as:

- An application on behalf of municipal workers to interdict their transfer to new corporate entities created by the Johannesburg Metropolitan Council on the grounds that the employees consent had not been obtained,[76] and
- An application for a declaratory order that the transfer of employee's contract of employment to a subcontractor did not constitute a transfer in terms of section 197, coupled with an interdict restraining their employer from proceeding with the transfer.[77]

It can be concluded from the above cases that employees seeking the protection of section 197 are best advised to apply for a declaratory order to this effect, combined with an order requiring the old and new employers to do whatever is necessary to comply with the relevant requirements of section 197. An application for an interdict restraining the

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[75] NEHAWU v University of Cape town & Others (2000) 7 BLLR 803 (LC)

[76] IMATU & Others v Greater Johannesburg Metropolitan Council & Others (2000) 12 BLLR 1449 (LC)

[77] NUMSA v Staman Automatic cc & another (2003) II BLLR 1167 (LC)

employers from completing the transaction pending compliance with section 197 will in all probability fail unless clear evidence is provided of, (i) employee's entitlement to the protection of section 197, for example, acknowledgement of this fact by both employers; and (ii) irreparable harm that employees will suffer if the transaction were to proceed in the absence of the remedy sought. In practice this combination of circumstances is less likely to arise.

4.3 Against whom must remedy be sought?

The employer against whom a remedy is sought must be cited in any claim by employees based on the provisions of section 197 in respect of rights or obligations that have been transferred from the old employer to the new employer. This will invariably be the new employer since, if the claim succeeds, a remedy can only be ordered against the new employer.

Where any doubt exists, however, both employers should be cited; alternatively, application can be made for the other employer party to be joined.[78] Thus, in a dispute based on alleged unfair dismissal by the old employer, failure to join the new employer was held to be fatal to the employees' claim because, on the facts of the matter, an order could only be made against the new employer.[79]

4.4 Contractual Claims

There are two types of contractual claims, that is, claims arising prior to the transfer and claims arising after transfer.

4.4.1 Claims arising prior to transfer

Section 197 (9) states that "the old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to

[78] Unless the party in question waives its right to be joined: Success Panel Beaters v NUMSA & another (2000) 6 BLLR 635

[79] Halgang Properties cc v Western Cape Workers Association (2002) 10 BLLR 919 (LAC)

the transfer." This provision should be seen in the context of concerns expressed by trade unions about the position of employees who, in consequence of an agreement for the transfer of a business over which they have no control, may find themselves transferred to a new employer which is financially unsound.[80] It is a number of measures in the amended LRA that should encourage employers to apply their minds more carefully to the outcomes of their transaction. The Explanatory Memorandum to the 2000 Amendment Bill spoke by making both employers liable "for claims arising prior to the transfer." However, only claims concerning terms and conditions of employment are referred to in section 197 (9). The "terms" presumably refers to contractual terms, both implied and express.[81]

It has been noted that an employee who has been unfairly dismissed by the old employer is not confined to seeking a statutory remedy from the new employer but may, in the alternative, sue the employers jointly and severally on the basis of breach of contract.[82] And the term "conditions" appears to be used not only in contractual sense but also with reference to minimum conditions of employment laid down by the BCEA and other statutes or wage – regulating measures.

While such "conditions" amount to implied terms of the contract of employment,[83] the use of the word "conditions" avoids any uncertainty in this regard. Again, the new and the old employers can be held liable jointly and severally for any claim arising from an infringement of this nature by the old employer.

4.4.2 Claims arising after transfer

In cases where a new employer, after a transfer in terms of section 197, provided the employee with conditions or circumstances at work that are substantially less favorable to the employee than those provided by the old employer, an employee, instead of resigning,

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[80] Seeing Millennium Labour Council agreement (April 2001) unpublished
[81] Chris Todd Supra at p. 191
[82] Fedlite Assurance Ltd v Wolfaardt (2001) 12 BLLR 1301
[83] Section 4 of BCEA provides that a basic "condition of employment" constitutes a term of any contract of employment except to the extent that an equivalent contractual term imposed by any other law, is more favorable to the employee

may also adopt the less extreme option of seeking to enforce his or her contractual rights against the new employer. The basis for doing so would be that in terms of section 197 (2) (a), the new employer assumes the duties of the old employer in terms of the contract of employment.

In the absence of an agreement[84] to vary those conditions, providing an employee with "conditions" or circumstances" that are substantially less favorable" than those previously enjoyed will in most cases amount to breach of contractual terms, and possibly, repudiation of the contract as a whole.[85] In the latter event, in terms of the common law, the employee may elect whether to terminate the contract or hold the employer to its terms by claiming specific performance.[86]

4.6 Agreements in terms of section 197 (7)

Section 197 (7) provides that the old employer must –

(a) agree with new employer to a valuation as at the date of transfer of-

(i) the leave pay accrued to the employees of the old employer;

(ii) the severance pay that would have been payable to the transferred employees of the old employer in the event of a dismissal by reason of the employer's operational requirements; and

(iii) any other payments that have accrued to the transferred employees but have not been paid to employees of the old employer;

(b) conclude a written agreement that specifies –

(i) which employer is liable for paying any amount referred to in paragraph (a), and in the case of the apportionment of liability between them, the terms of that apportionment; and

(ii) what provision has been made for any payment contemplated in paragraph (a) if any employee becomes entitled to receive a payment;

(c) disclose the terms of agreement contemplated in paragraph (b) to each employee

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[84] i.e. in terms of section 197 (7) 7

[85] See, in general, Hutchison *Wille's Principles* at 510-514

[86] NUTW & Other v Stag Parkings Ltd & another (1982) 3 ILJ 285, Chevron Engineering Ltd v Nkambule & Others (2001) 4 BLLR 395(LAC)

who after the transfer becomes employed by the new employer; and

(d) take any other measure that may be reasonable in the circumstances to ensure that adequate provision is made for any obligation on the new employer that may arise in in terms of paragraph (a)"

A close analysis of the above provisions shows that paragraph (a) makes no provision for the creation of binding obligations; its object is limited to setting the amounts of the payments to be regulated in terms of paragraph (b). Consensus over these amounts cannot be compelled. Should the parties fail to reach consensus, whether through negligence of the old employer or the reluctance of the new employer, it is difficult to see what can be done except, in theory seek an order requiring the old employer to make *bonafide* efforts to reach agreement as to the listed amounts. Paragraph (b) is concerned with regulating the liability of the two employers for meeting those claims in paragraph (a).

The question of enforcing paragraph (b) can only arise if consensus in terms of paragraph (a) has been reached. In the absence of such consensus, the enforcement procedures laid down in chapter ten of the BCEA would have to be invoked to compel payment, and if necessary determine the amount, of employee's claims to leave pay and severance pay.[87]

Paragraph (c) places a clear duty on the old employer (but not the new employer) to disclose the terms of any agreement signed in terms of paragraph (b) to "each employee who after the transfer becomes employed by the new employer." Therefore, the duty apparently does not extend to the amounts of employee's accrued claims agreed between the employers in terms of paragraph (a) but only to the written agreement apportioning their respective liability *vis a vis* each other.[88]

Further, the duty to disclose the terms of such agreement is not qualified by the usual limitations.[89] The implication is that no valid reason exists for limiting employee's access

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[87] i.e. in terms of SS 40 and 41 of the BCEA, as contemplated in s. 197 (7) (a) (i) and (ii)
[88] Chris Todd Supra at p. 196
[89] As set out in SS 16 and 89 LRA, and incorporated into S. 189

to information in question and, therefore, the agreement must be disclosed in full. Under paragraph (d), affected employees could seek an order requiring the employer to comply with its commitments. Although no remedy is provided in the event of failure by the old employer to comply with paragraph (d), the effect would be to create a species of joint and several liabilities of the old and the new employers.

Chapter 5

5.0 SHORT COMINGS IN THE SOUTH AFRICAN SYSTEM

5.1 GENERAL OVEREVIEW

Section 197 of the Labour Relations Act places heavy responsibilities on the employer who takes over the business (or part there-of) of another employer as a going concern. It forces the new employer to takeover all the labour-related obligations of the old employer. However, it has certain short comings which we shall explore in this Chapter and try to offer suggestions on how the law can be improved to protect employees in mergers and acquisitions.

As discussed in Chapter three, the term "business" includes any employers' undertaking be it big, small, profit making or non-profit, unionised or not, private or government. However, not all takeovers fall under this legislation because not all are transfers "as going concerns". It is vital for employers to know which transfers do and do not fall under this legislation because they need to know whether the employer will be forced to takeover all the old employer's employees and whether the new employer will have to recognise and preserve all the benefits, remuneration working conditions, years of service and other rights of the employees.

Unfortunately the Labour Relations Act does not define what a transfer "as a going concern" is. This causes great confusion and sparks many disputes between employers on the one hand and employees and trade unions on the other hand. That is, takeovers or mergers often cause loss of jobs and employees are often desperate to stay on with the new enterprise. On the other hand, the new entity very often already has its own staff and wants to avoid the expense of taking on additional employees. However, the legislation is not clear enough to tell the parties whether the new entity must or must not comply with section 197 of the Labour Relations Act.

5.2 The issue of outsourcing

The issue of outsourcing, especially second generation outsourcing will cause possible future problems relating to the interpretation of section 197. In *Samwu and others v Rand Airport Management Company*,[90] as discussed earlier, the Labour Court found that the transfer of part of an employer's structure did not comprise a recognizable entity and therefore did not constitute the transfer of a going concern. However, the Labour Appeal Court later overturned this decision.

This may have been partially due to the fact that the 2002 amendments to the Labour Relations Act expanded the scope of the section 197 provision. These amendments provided by a business constituted a transfer as a going concern. The Labour Court Judge in the *University of Cape Town* case reached the conclusion that outsourcing was not a transfer as envisaged in section 197 because *inter alia* the transfer was not of a permanent nature. At the end of the contract the outsourcer could decide to reverse the process and take the staff back.

What, however, if the outsourcing party decides to terminate the business with the new contractor? Does section 197 come into force with respect to the new transfer? Transfer is defined in section 197(1) (b) as "the transfer of a business by one employer (the old employer) to another employer (the new employer) as a going concern." A strict reading of the Act says that there is no transfer in the instance mentioned above. There is no contact between the old contractor and the new outsourcing party.

The existing contractor does not transfer the business, the original employer actually transfers the business. In that context it would appear that the old outsourcing party could merely dismiss the workers it was not able to keep or redeploy by reason of its operational requirements. Bosch[91] finds the notion that the "transfer" does not comply with section 197 and so provides blanket exclusion for section 197, very unsatisfactory. A drafting oversight would deny the employees the protection afforded by section 197.

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[90] (2005) 3 BLLR 241 (LAC)
[91] Bosch at 930

Bosch believes that the issue is not whether or not there is a transfer, but whether what is transferred is a going concern. He believes that something will be transferred between the out going to the incoming contractor. First of all, in my view, there is no certainty that anything will be transferred. If the original contract is for a number of years, the equipment will probably have been replaced over the period and a large number of the staff will have left and have been replaced, others would have been transferred to other contracts run by the outsourcing company.

Experience has shown that in cleaning contractors, for example, the staff turnover is high both by way of voluntary dismissal and by way of transfer to another contract with the new company. And if there is no transfer between the old contractor and the new contractor, either by way of the interpretation of section 197 or by way of fact, then the test of a going concern does not come into play.

To get round this problem, Bosch postulates that the entire service is transferred to the new contractor by the out going contractor but in a two stage notional process via the outsourcing party. He contends that there is nothing in section 197 that requires the transfer from one employer to another to occur in one stage. However, in my view section 197 does not support that contention- it is clear that the legislators did not envisage the process of second generation contracting out.

Otherwise it would have framed the regulation differently. The two staged transfer is difficult to comprehend when there could be a lapse of a number of years between the stages. Finally when we are asked to accept the notion of the two stage transfer, we are enjoined to have regard and substance and not the form of the transferring transaction. On the same basis we are asked to regard the lack of a contractual relationship between the old contractor and the new contractor as insignificant.

In this regard Bosch refers to a number of European cases where the first generation contracting out employees are transferred to the second generation contractor but with the rider that "the European authorities have held, however that the lack of any contractual link between the transferor and the transferee might mitigate against the transfer as a going concern.[92] As in the University of Cape Town the case the issue may find its way to the Constitutional Court. In this eventuality the Constitutional Court may adopt the

[92] Bosch at 931

same approach as it did in the *University of Cape Town* case in that Chapter VIII of the Labour Relations Act is a direct manifestation of the constitutional right to fair labour practice; and if a lower court did not apply section 197 in the case of a second operation transfer, it would have denied workers the fair labour protection of section 197. An interesting prospect.

5.3 Determination of employees to be transferred

Another pertinent issue that may arise from section 197 transfer is to determine the employees that are transferred. This is relatively straight forward when looking at an integrated self standing unit but if it is part of a unit which has support staff elsewhere or workers also service more than one unit, how are they to be treated? In a European case[93] the European Court of Justice invoked the test that it was sufficient to determine to which part of the business the employee was assigned.

Nevertheless in that case the court decided that the support staffs were not covered by the transfer. A useful test of assignment appears in another European case[94] viz the amount of time spent in differing parts of the business, the amount of value given to each part, the terms of the employment contract and how the costs of the employee's service are apportioned.

In the European cases quoted by Bosch[95] in this matter it appears necessary that the assignment is to one specific part of the business to prevent confusion as to when parts or even sub-divisions of parts are transferred. Again from the European experience of transfers, the courts will have to be vigilant to the possibility that employers may intentionally transfer employees that they wish to get rid of to a part of the business which is to be transferred to a third party and so avoid the problems associated with a non-performance dismissal.

Bosch does not address the issue but the reverse may also occur. The transferring employer may hold back employees that the employer does not wish to transfer and so

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[93] Bozon v Rotterdamsche Maatschapp BV (1986) 2 CMLRS (ELJ)
[94] Duncan Webb offset Ltd v Cooper (1995) RLR 633 (EAT)
[95] C. Bosch "of Business Parts and Human Stock:" Some Reflections on section 197 (1) (a) of IRA (2004) 25 ILJ at 1880

retain the benefit of their services. In this case the employee or the new employer may feel aggrieved and wish to take action.

5.4 Other issues

The principles contained in section 197 of the Industrial Relations Act, namely that employment relationships between the employee and the new employer remain unaltered upon transfer of a business or undertaking are indeed a step in the right direction.

However our concern is about how this section is being undermined by business. The one way is obviously the placing of businesses into provisional liquidation and the buying of these companies once they are provisionally liquidated.
In terms of section 38 of the insolvency Act the employees contracts are terminated upon provisional liquidation and when the business is transferred, no contracts exist for transfer. This loophole must be closed by amending the insolvency Act by getting rid of section 38.

Another way is the retrenchment of workers prior to the sale because the purchaser requires fewer workers. The sale becomes the operational reason for the dismissal of workers. This undermines the very point of section 197. Perhaps more importantly, and this is common in cases of subcontracting, retrenchments are proposed after the subcontracting (and the transfer of the business) has occurred. Even though at the time of the transfer there were no job losses, the job losses that eventually do occur are because of the subcontracting. This means that the reason or need for the retrenchments is not open for negotiations-the retrenchments are an *au fais accompli*, and all a union can do is consult about the extent and modalities of the retrenchments. Therefore, we propose that the Labour Relation Act must be amended so that employers have a duty to disclose any possible sub-contracting or restructuring so that the union may engage in negotiations before the sub-contracting takes place. This will allow the union to campaign for job security agreements in the sale of the business.

The other problem with section 197 relates to uncertainties about benefits and terms and conditions of employment. For example, a large company in the metal industry subcontracts its transport division to another company. The workers in the transport

division of the large company are transferred to the other company. While employed by the large company, they fall within the scope of the engineering bargaining council.

Now because the second company employs them, they fall within the scope of the road freight bargaining council. This has severe implications for their pensions and medical aid benefits which are actually administered by the respective councils. While the obligations of the employer are transferred from the large company to the second company, the nature of and extent of benefits often do not have anything to do with the obligations of the employer. Clarity on these matters should be provided for in order to protect the interests of workers.

5.5 Conclusion

This dissertation started off by way of introduction outlining what constitutes a merger, an acquisition and the nature of the contract of employment. When acquiring another company, the purchaser will often restructure certain areas of the newly acquired company and this will inevitably have an effect on the current employees of such a company. However, before a purchaser proceeds with a transaction, it must be aware that it will not be permitted to pick and choose what employees stay on with the newly acquired company and the terms under which those employees remain employed.

In the United Kingdom, the relevant legislation governing employee transfers is the transfer of undertakings (protection of employment) Regulations 2006 ("TUPE 2006") which came into force on 6 April 2006 (replacing the 1981 TUPE Regulations). Prior to the implementation of TUPE, the position in the United Kingdom was that where there was no change in the identity of the employer, the employees' contracts of employment would continue unamended.

Therefore, if a company is acquired by purchasing the shares of that company there is no change in the identity of the employer (as it remains the same company) and consequently no change in the employees' contracts of employment. However, where the business is purchased by an asset sale the original UK common law position was that the employees were left behind and the purchaser was entitled to pick and choose what employees it would offer employment to and the terms of such employment.

TUPE altered this common law position by providing that where an asset sale amounts to the transfer of a business as a going concern, all rights, duties and liabilities in relation to the acquired company's employees are transferred with the business. The purchaser is therefore obliged to continue with the employment of such employees on their purchases need to be aware that TUPE protects employees against any changes to their terms of employment which are connected to the transfer even if the employees agree to such changes.

The only exceptions to this rule are changes that are an economic, technical or organizational reason entailing changes to the workforce. However, few contractual changes will meet this requirement, with the UK courts having held that a "change in the workforce" must involve a change to the numbers, functions or levels of the employees. While TUPE 2006 has relaxed the provisions dealing with amendments to employees' terms of employment where the selling business is subject to certain insolvency proceedings, the proposed changes must still be agreed with a representative of the employees

As TUPE only governs asset and not share sales no similar provisions exist for a sale of shares and employers are free to amend the term and conditions of employment of employees (provided of course that they obtain the employee's consent). It is hard to rationalize such a distinction and it is certainly an aspect that a purchaser will need to take into consideration when deciding whether to acquire a business in the United Kingdom by way of its assets or by way of its shares.

In South Africa, as in the United Kingdom, if a company is acquired by purchasing the shares of that company there is no change in the identity of the employer and consequently no change in the employees' contracts of employment. However, should a company go by a way of an asset purchase then such purchase will be subject to section 197 of the Labour Relations Act, 1995 ("the LRA") which governs transfers of contracts of employment on the sale of a business.

Section 197 provides that if the whole or a part of a business is transferred as going concern to a purchaser then the purchaser is automatically substituted in the place of the old employer (the seller) in respect of all contracts of employment in existence immediately prior to the date of the transfer. This means that anything done before the

transfer by or in relation to the old employer is considered to have been done by the new employer (the purchaser), although the old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to the transfer (although liability for any criminal actions will remain with the entity responsible for such actions).

The new employer will comply with section 197 if it employs the transferred employees on terms and conditions that are "on the whole not less favorable to the employees" than those on which they were employed by the old employer. However, if the employees' conditions of employment are determined by a collective agreement and not entitled to offer terms that are "on the whole not less favorable". Should the old and/or the new employer wish to alter the terms and conditions of employment of certain employees they may do so by entering into an agreement with the affected employees.

Where the new employer employs the transferring employees on terms and conditions that are less favorable and an employee resigns as a result thereof, such a resignation will be regarded as an unfair dismissal by the new employer. Section 197 also requires the old employer to conclude a written agreement with the new employer setting out the amounts and which employer (the old or the new) will be liable for accrued leave pay, severance pay that would have been payable to the transferred employees in the event of a dismissal by reason of operational requirements and any other payments that have accrued to the transferred employees but have not yet been paid by the old employer.

The 2002 amendments attempted to address some of the grey areas but certain issues that have not been fully addressed include the definition of what constitutes a transfer of a business as a going concern (and whether this includes outsourcing), the process of a bargaining prior to the transfer, disclosure of information about transfers, voluntary retrenchment instead of transfer and the impact of transfers on collective bargaining arrangements. There is need to make legislative changes to address the above issues but in the meantime, there is need to campaign for collective agreements that provide a frame work for the regulation of transfers of businesses as going concerns. In addition, employees and their representatives will have to carefully contest the issues relating to

transfers in the labour courts, particularly those relating to what constitutes a transfer as a going concern.

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