

**An analysis of employee protection in business
transfers:**

**Is the purpose of section 197 subverted by
judicial interpretation in outsourcing contracts?**

by

Vongai Masocha (MSCVON001)

Submitted to **The University Of Cape Town**

in fulfilment of the requirements for the degree LLM

Faculty of Law, University of Cape Town

Supervisor: Emma Fergus

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Research dissertation presented for the approval of the Senate in fulfillment of part of the requirements for LLM in Labour Law in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

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

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Signed:

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Abstract

Employment security is a fundamental right that stems from the prohibition of unfair dismissals in the Labour Relations Act.¹ Section 197 bridges the gap between business transfers and unfair dismissals by creating an automatic transfer of employment contracts of any employees affected by the transfer of a business by an old employer to a new employer as a going concern. The wording of the section is however, problematic. From the time that it was promulgated, the true meaning of section 197 has been heavily debated. The Legislature's intention to protect employment security and facilitate the efficient transfer of businesses has been identified by courts. However, the difficulty faced in interpreting this provision raises the question of whether the purpose of the section is being subverted by judicial interpretation.

1. Introduction

The transfer of a business as a going concern by one employer to another is a transaction that has significant effects on a wide range of people. These effects permeate into the commercial, legal, and socio-economic aspects of the affected individuals' lives. The affected individuals range from employers, stakeholders and employees of the business, to the individuals in the general public who have interests within a particular business. The legal transfer of a business to a new employer shifts a collection of rights and obligations concerning the affected employees to the aforementioned employer, who essentially steps into the shoes of the old employer in this respect.² Thus to the extent that the LRA seeks to advance economic development, social justice, labour peace and the democratisation of the workplace,³ the role played by section 197 in regulating business transfers is of great importance in the labour relations sector.

¹ Act 66 of 1995. Hereafter referred to as the LRA.

² C Todd et al, 'Business Transfers and Employment Rights in South Africa', LexisNexis Butterworths 2004, at 8.

³ Section 1 of the LRA

The purpose of section 197 is analysed, with specific reference to the legal lacuna that the Legislature had to fill due to the inadequacy of the common law in regulating business transfers.⁴ This paper analyses the manner and degree of efficacy in which section 197 regulates business transfers, particularly in light of the role that the provision plays in balancing the apparently conflicting rights of employers and employees. As set out by the Constitutional Court in *NEHAWU v University of Cape Town*,⁵ the inherent clash of interests that characterises labour relations in South Africa reaches its peak when the transfer of a business to a new employer is contemplated.⁶ Thus, the interests of both employers and employees in the context of a business transfer are analysed in this paper. It is submitted that despite the fact that section 197 balances the interests of both employers and employees, this paper seeks to analyse whether courts are giving effect to their constitutional mandate to protect employees,⁷ who are still a vulnerable group in South Africa. Thus the manner that section 197 is interpreted and applied by judges will be scrutinised, especially in light of the purpose that section 197 plays in ensuring that employees faced with a change in employer have the right to employment security. The courts' interpretation of section 197 will also be measured against the approach adopted in foreign jurisdictions when attempting to interpret and give effect to business transfer legislation.⁸

This paper focuses on the application of section 197 to cases where a part of a business is outsourced to another business. Outsourcing ventures and businesses are a rapidly growing market in South Africa. Ranging from governmental bodies, parastatals, universities to private businesses,⁹ employers are increasingly opting to contract with an outside party to provide for certain services within the business, or the performance of specific work. Outsourcing was initially used to describe a decision by a business to obtain services from an outside party, that it

⁴ See Chapter Two.

⁵ 2003 (2) BCLR 154 (CC).

⁶ *Ibid* para 31.

⁷ Section 23 of the Constitution guarantees employees the right to fair labour practices.

⁸ See page 27, Section 4.3.

⁹For example, the latest 'Non-financial census of municipalities' for the year ended 30 June 2012 by Statistics South Africa indicated that the total number of municipalities that outsourced electricity services to private companies rose from 20 in 2009, to 166 in June 2012. This has permeated into the private commercial sector, although it is difficult to acquire reliable statistical data on this.

had hitherto carried out internally or obtained by employing its own staff.¹⁰ There are a wide variety of services that can be carried out in outsourcing businesses. The services could be relatively menial,¹¹ or require technical skills.¹² Even highly skilled or professional activities may be the subject of outsourcing.¹³ However, the analysis of outsourcing is particularly important in services that involve routine manual labour, given that predominantly unskilled labourers perform these tasks. These are oftentimes vulnerable members of society, and need protection against unfair labour practices and unfair dismissals.¹⁴ Thus, coupled with the ever-growing popularity of these commercial structures, the influx of outsourcing cases in South African is unsurprising. This is therefore a relevant area of law that is in great need of clarification.

This paper highlights the difficulties in interpreting section 197; a section which has unfortunately been surrounded with confusion and debate since it was enacted in the 1995 LRA.¹⁵ The major source of controversy is the threshold clause in section 197(1), which determines the applicability of the section to a given set of facts. It is necessary to state at the outset that three important factors have been identified as the trigger mechanisms for the application of section 197.¹⁶ Firstly, there must be an entity that is the whole or part of a business. Secondly, the transfer must be carried out by one employer to another. Thirdly, the transfer must be carried out as a going concern.¹⁷ Thus the paper attempts to examine how the courts have construed the contentious clauses, with particular reference to outsourcing contracts.¹⁸ It is anticipated that the primary issues that arise when interpreting the section in outsourcing cases are whether a service can amount to a business under section 197(1)(a), and

¹⁰ M Wallis, 'It's Not Bye- to 'By': Some Reflections on Section 197 of the LRA' (2013) 34 ILJ 779, at 794.

¹¹ Such as cleaning of offices and other business premises, garden maintenance, waste management, security guards, laundry services, a call centre, or the operation of catering services or a canteen.

¹² Such as fleet maintenance, logistical support, or the provision of transport services.

¹³ For example, the provision of legal or accounting services, computer services, public relations or airport management services.

¹⁴ See note 31.

¹⁵ C Todd et al, op cit note 2 at 21.

¹⁶ *Schatz v Elliott International (Pty) Ltd & Another* (2008) 29 ILJ 2286 (LC).

¹⁷ *Ibid* para 36.

¹⁸ See Chapter Five.

the meaning of the requirement that a transfer to be carried out 'by' an old employer to a new employer.¹⁹ The adequacy of section 197 in protecting the right to employment security will thus be scrutinised. It is anticipated that the lack of consensus in South African courts on how to interpret section 197(1) is the main contributing factor to the difficulties surrounding section 197, which raises the question of whether the courts are giving effect to the purpose of the section.

2. Chapter One- The common law position and legislative developments

In order to sufficiently grasp the purpose of section 197, it is necessary to analyse how the common law regulated the transfer of a business as a going concern. This chapter analyses the state of business transfer law before section 197 was enacted in the 1995 LRA. The discussion below thus analyses how the common law position failed to give effect to both the employee and employer's rights and interests.

2.1. Business transfers under the common law

Prior to the 1995 LRA, there was no general statutory protection of employees upon the transfer of a business.²⁰ With almost no mention of the legal consequence of business transfers in the legislative framework,²¹ the common law regulated this matter. Under this system, the default position was the termination of employment contracts upon the transfer of a business. The only possible alternative to termination was the novation of the employment contract by way of agreement between the employee and the new employer. If novation was agreed on, the old

¹⁹ In terms of section 197(1)(b).

²⁰ W Blackie et al, '*Transfer of Contracts of Employment as a Result of Mergers and Acquisitions: A Study of Section 197 of the Labour Relations Act 66 of 1995*' (1999) 20 ILJ 1387 at 1387.

²¹ However, section 22(5)(a) of the Manpower Training Act 56 of 1981 provided for automatic transfers of apprenticeship contracts upon the dissolution and subsequent revival of a partnership by new partners. Section 12 of the Basic Conditions of Employment Act of 1983 also allowed for the transfer of an employee's accrued leave benefits upon transfer of a business; but only if the new employer chose to retain the employee.

contract would be replaced with a new one- with the terms and conditions thereof completely at the new employer's discretion.²²

The main policy reason behind the common law position, as set out in *Nokes v Doncaster Amalgamated Collieries Ltd*,²³ was the characterisation of employment contracts as personal contracts existing between an employer and employee. The identity of an employer was by principle, regarded as fundamental to the employment contract in English law.²⁴ As a result, the law was structured to protect the privity of contract between the two original parties to an employment contract. In *Nokes*, Lord Atkin expressed that the personal relationship between an employer and his employee could not be unilaterally altered by the former.²⁵ Consequently, the employee's consent was required before his employment contract could be transferred to the new business owner.

The Industrial Court analysed the common law rules in *Kebeni & others v Cementile Products (Ciskei) (Pty) Ltd & another*,²⁶ where the respondent company took ownership of another company, purely to carry out (otherwise unlawful) selective re-employment of employees. The Industrial Court, per Bulbulia M gave a progressive judgment and went beyond a rigid application of the common law, in order to protect the unfairly dismissed employees. Looking at the facts of the case, the employees were merely pawns 'in a ruse to enable the (employer) to carry out an exercise in selective re-employment.'²⁷ Under the common law, the termination of employment contracts for transfer purposes fell outside the scope of the unfair or automatically unfair dismissal inquiries.²⁸ Furthermore, any possibility of re-employment was completely at the discretion of the respondent, which used subjective and commercially-motivated selection criteria.²⁹ Thus the case illustrated the vulnerability of employees under the common law system,

²² W Blackie et al op cit note 20.

²³ (1940) AC 1014 (HL).

²⁴ Op cit Todd et al note 2 at 7.

²⁵ In this regard, Lord Atkin held that an employee's right of choice 'constituted the main difference between a servant and a serf', at 1026.

²⁶ (1987) 8 ILJ 442 (IC).

²⁷ Ibid, at 446.

²⁸ Ibid at 447.

²⁹ Ibid.

which did not sufficiently protect employees in cases where business transfers were being misused by employers.³⁰

In this regard, *Bulbulia M* held that, ‘unilateral conduct is not always fair simply because it has a commercial rationale to it.’³¹ In addition, there must be legitimacy present when drastic actions such as business transfers are decided on. *Bulbulia* relied on the principle of fairness to develop the common law to the extent that substantive and procedural fairness have to be considered, especially in the process of retrenching for transfer purposes.³² Furthermore, he formulated a procedural guideline to ensure that employees receive fair treatment in any circumstances contemplating a change in employer.³³

Most importantly, the Court suggested that parties to a business transfer should contractually bind themselves to what amounts to an automatic transfer of employee contracts from the old employer to the new employer, once the business has been transferred.³⁴ *Bulbulia M* raised the suggestion of automatic transfer of employee contracts in terms of ‘safeguard clauses’, which would essentially protect workforce security in business transfers. These clauses would render all employment contracts transferred to the new employer, who would then be obliged to retain all existing employees without discrimination, unless an individual employee chooses not to continue his employment.³⁵ This dictum was directly influenced by English law, which regulated employee protection in business transfers at the time.³⁶

³⁰ The transfer *in casu* occurred subsequent to ‘labour problems’ arising from disputes between a trade union and the employer. This had become a common practice prior to the enactment of section 197.

³¹ *Ibid* at 449.

³² *Ibid*.

³³ The procedure should at least include adequate notice and consultation of the proposed take-over by the employer; sufficient prior notice of the take-over; an agreement between the transferor and transferee of the employees’ rights.

³⁴ *Ibid* at 450.

³⁵ *Ibid*.

³⁶ *Bulbulia M* compared the use of these safeguard clauses to that of the Transfer of Undertakings: Protection of Employment Regulations of 1981 in the UK. Regulation 4(1) states that, ‘a relevant transfer shall not operate so as to terminate the contract of employment of any person employed by the transferor and assigned to the organised grouping of resources or employees that is subject to the relevant transfer.’

The judgment in *Kebeni* set in motion possible development of business transfer law. However, the progressive judgment did not actually develop the common law, as the employer was held liable in terms of ordinary unfair dismissal law. Furthermore, subsequent cases reverted to reliance on the common law. In *Ntuli & others v Hazelmere Group*,³⁷ the Industrial Court gave a disappointingly regressive judgment which gave effect to neither the principles formed in *Kebeni*, nor to foreign examples of transfer of undertakings law. Adopting a formalistic interpretation of the common law, the Court in *Ntuli* held that there was no foundation for the argument that there is continuous employment with a new employer subsequent to the transfer of a business.³⁸ The Court interpreted continuous employment as a contractual right, borne out of agreement between the transferee and the employees. Therefore, the transfer of employment contracts to the new employer was not a right, but a state of affairs ‘conditional in law’.³⁹ Thus the Court rejected the idea of automatic transfer of employment contracts as an appropriate solution.⁴⁰ The examples set by international labour jurisprudence were also rejected, as the principles of equity did not require the Court to adopt the principles embodied in the European Economic Community Directive 77/187⁴¹ (which section 197 was drafted very similarly to).⁴²

The discussion above illustrates that despite the awareness by courts that the common law was inadequate in regulating business transfers, nothing was being done to change that. Courts were deferential to business owners, and based the obligation on employers to retain employees on principles of contract law. Not only did this prejudice the socio-economic interests of employees, but it also hampered the transfer process, to the detriment of the employers. For example, if a new employer wished to keep an entire workforce, lengthy negotiation periods would understandably ensue during the employment contract novation process. However, the principles established in *Kebeni* did not fall on deaf ears, as the LRA was eventually amended to include section 197, which came into effect in the 1995 LRA.

³⁷ (1988) 9 ILJ 709 (IC).

³⁸ *Ibid* at 718.

³⁹ *Ibid*.

⁴⁰ *Ibid* at 720.

⁴¹ The Acquired Rights Directive 77/187/EEC.

⁴² *Supra* note 37 at 719.

2.2. Section 197

This section analyses the individual provisions of section 197. The discussion will be limited to the sections that are relevant to the scope of this paper.

2.2.1. The threshold clause

Subsection (1) is the central clause in the section, as it determines whether or not a particular set of facts falls within the section's scope. For the purposes of this discussion, the full clause is set out below:

- '(1) In this section and in section 197A -
- (a) 'business' includes the whole or a part of any business, trade, undertaking or service; and
 - (b) 'transfer' means the transfer of a business by one employer ('the old employer') to another employer ('the new employer') as a going concern.'

Section 197(1) defines the two factors that must be present in order for the section to apply. First, the Act defines a 'business' - stating that the entity being transferred must include 'the whole or a part of any business, trade, undertaking or service'.⁴³ Secondly there must be a 'transfer' of a business by the old employer to the new employer.⁴⁴ As will be discussed below, section 197(1) is the threshold which determines the applicability of section 197 to a transfer of a business. The vague drafting language used in section 197(1) has resulted in courts and labour tribunals grappling with the correct manner of interpreting the clause.⁴⁵ The Act is silent on what actually constitutes a 'transfer as a going concern', which has been left to the courts to give substance to. The confusion is particularly exacerbated when the business involved in a transfer is part of an outsourcing contract.⁴⁶ Therefore, the efficacy of section 197 is potentially compromised by the lack of clarity on when the section should or should not apply.

⁴³ Section 197(1)(a).

⁴⁴ Section 197(1)(b).

⁴⁵ C Bosch, '*Transfers of Contracts of Employment in the Outsourcing Context*' (2001) 22 ILJ 840, at 841.

⁴⁶ *Ibid.*

The threshold test in section 197(1) removed the common law requirement of consent by the employees in order for the legal consequences in section 197(2) to take place. In this regard, section 197 is a legislative exception to the common law principle that a contract of employment may not be transferred without the employees' consent.⁴⁷ This is unlike Section 197(1) of the 1995 LRA, which stated that a contract of employment 'may not be transferred from one employer (the old employer) to another employer (the new employer) without the employee's consent.'⁴⁸ Under the new LRA, employees are therefore unable to disturb the legal effects of section 197 by refusing to be transferred, as their consent is not necessary for the section's operation. The employee may, however opt to resign if they are unwilling to be transferred to the new employer.⁴⁹

2.2.2. Legal consequences of section 197

Section 197(2) sets out the legal consequences of section 197 when applied to a transfer of a business as a going concern. First, the new employer automatically substitutes the old employer in respect of all employment contracts in existence immediately before the transfer.⁵⁰ Secondly, all rights and obligations between the old employer and employee at the time of transfer are transferred to the new employer,⁵¹ unless the business is insolvent.⁵² Thirdly, any legal action carried out by the old employer before the transfer will be considered as carried out by the new employer,⁵³ except in insolvent circumstances.⁵⁴ Finally, the business transfer will not interrupt

⁴⁷ *Van der Velde v Business & Design Software (Pty) Ltd & another* (2006) 10 BLLR 995 (LC), at para 22.

⁴⁸ The inclusion of this phrase resulted in confusion pertaining to whether or not consent of the employee was a trigger mechanism for the application of the section.

⁴⁹ C Bosch, 'Balancing the Act: Fairness and Transfers of Businesses' (2004) 25 ILJ 923, at 936.

⁵⁰ Section 197(2)(a).

⁵¹ Section 197(2)(b).

⁵² In insolvent circumstances, section 197A(2)(b) applies and the rights and obligations remain with the old employer.

⁵³ Section 197(2)(c).

⁵⁴ If the business is insolvent, section 197A(2)(c) applies and anything done by the employer before transfer remains an action carried out by the old employer.

an employee's continuity of employment, and their employment contract continues with the new employer.⁵⁵

The consequences discussed above came into effect after some amendments were made to the LRA in 2002.⁵⁶ The inclusion of the word 'automatically' in subsection 2(a) was a conscious effort by the Legislature to clarify the confusion surrounding whether or not consent of the employers or the employees was necessary for the section to apply.⁵⁷ Prior to the amendment, the Court in *Foodgro, A Division of Leisurenet Ltd v Keil*⁵⁸ spoke on why section 197(2) should be interpreted in a manner that provided for the automatic transfer of employment contracts, once the requirements in subsection (1) were met. Froneman DJP (for the majority) held that the Legislature obviously intended for section 197(2)(a) to apply automatically because:

'If the purpose was to make it as easy as possible for purchasers to acquire a business from another without incurring obligations to existing employees, the introduction of s 197 would have been unnecessary. The common law would have created adequately for that situation.'⁵⁹

Subsections 2(b) and (c) of the current LRA state that all rights, obligations and actions pertaining to the old employer in respect of the employees become those of the new employer after transfer. Thus, an employer cannot shirk responsibilities owed to the employee, as they survive a change in the employer's identity. Furthermore, liability for unfair labour practices or dismissals carried out by the old employer is passed on to the new employer as if the latter employer committed the acts personally. The section thus prevents old employers from using business transfers as a means to circumvent liability for unlawful conduct, such as in the *Kebeni* case.⁶⁰ Subsection 2(d) ensures that an employee's continuity of employment is not interrupted

⁵⁵ Section 197(2)(d).

⁵⁶ Through the Labour Relations Amendment Act, No 12 of 2002.

⁵⁷ Supra note 3 para 65.

⁵⁸ (1999) 20 ILJ 2521 (LAC).

⁵⁹ Ibid at 2526.

⁶⁰ M Wallis op cit note 10 at 784.

by a change in employers. This consequence is particularly important when construed in light of pension benefits or long-service rewards.⁶¹

Section 197 states that ‘unless otherwise agreed’, the consequences in subsection 2(a) to (b) take place. This has been misconstrued as implying that section 197 only applies when there is prior agreement by the transferor and transferee that the workers are ‘part and parcel of the transaction.’⁶² This was eventually overruled by the Constitutional Court (CC),⁶³ which held that once the conditions in section 197(1) are met, the effects of subsection 2 follow by necessary implication.⁶⁴ Therefore the simultaneous transfer of a business and contracts of employment does not require any declaration by a court.⁶⁵ The transfer occurs by operation of law, and irrespective of the wishes or intentions of the parties.⁶⁶ An employee who refuses to be transferred to the new employer thus only has resignation as an alternative.⁶⁷ An old employer therefore cannot offer individual employees a choice between transfer to the new employer or retrenchment by the old employer.⁶⁸ However, section 197(6) introduces an element of flexibility by allowing the employee to enter an agreement with the employer(s),⁶⁹ and effectively alter the consequences of section 197(2).⁷⁰ This was confirmed in the recently decided case of *Experian*

⁶¹ See *AST Holdings (Pty) Ltd v Roos* (2007) 10 BLLR 891 (LAC), at 898.

⁶² *NEHAWU v University of Cape Town & others* (2002) 23 ILJ 306 (LAC), at 313.

⁶³ *Supra* note 3.

⁶⁴ *Supra* note 3 para 64.

⁶⁵ *Aviation Union of SA & another v SA Airways (Pty) Ltd & others* (2012) 3 BLLR 211 (CC), at 43.

⁶⁶ *Franmann Services (Pty) Ltd v Simba (Pty) Ltd & another* (2013) 34 ILJ 897 (LC), at para 7.

⁶⁷ C Bosch *op cit* note 49 at 936.

⁶⁸ In *Fourie & another v Iscor Ltd* (2000) 21 ILJ 2018 (LC), employees refusing to have their contracts transferred in a business transfer were offered a choice between transfer, or staying with the old employer and facing retrenchment. The Court chose not to pronounce on the legality of this action (as it was not raised in pleadings). However, Damant AJ at para 8.14 remarked that the respondent (employer) could have compelled the employees to transfer against their consent, given the automatic nature of section 197. However, this case was decided before the 2002 amendments, which effectively established that retrenchment is not an option for employees in the transfer context.

⁶⁹ Subsection (6) allows the agreement to be entered by the employee and either the old or new employer, or both employers.

⁷⁰ C Bosch *op cit* note 49 at 936

South Africa (Pty) Ltd V Haynes & another.⁷¹ The Court discussed the effect of ‘unless otherwise agreed’ in section 197(2)- stating that the consequences imposed by the subsection flow automatically, subject to the creation of a section 197(6) agreement between the employee and either of the employers.⁷² Therefore nothing in section 197(2) prohibits the concluding of a fresh agreement that regulates the rights and obligations in an employment relationship after the transfer of the employee to the new employer.⁷³ However, this must be construed in light of the proviso established by the Court in *Foodgro* that no agreement in terms of section 197(6) may result in the forfeiture of an employee’s period of service.⁷⁴

The Court in *Experian* also held that section 197(2) must be read together with section 197(3)(a), which allows the new employer to unilaterally change the terms and conditions that are, ‘on the whole on the whole not less favourable to the employees than those on which they were employed by the old employer.’⁷⁵ This section is a clear attempt by the Legislature to balance the employer’s rights to structure his business in a manner that is commercially efficient, and to protect employees’ fair labour practice rights by requiring a standard of fairness when doing so.⁷⁶ The phrase ‘on a whole not less favourable’ is not defined in the Act. It is thus difficult to establish when the conditions are less favourable enough to invoke section 197(3)(a). Some scholars have ascribed terms and conditions such as medical and pension benefits as factors which can be used to assess whether employment contracts have been altered by the new employer to the employees’ detriment.⁷⁷

Section 186(1)(f) provides protection to an employee who terminates their employment contract when a new employer provides them with ‘conditions or circumstances at work that are substantially less favourable to the employee than those provided by the old employer.’ This

⁷¹ 2013 (1) SA 135 (GSJ).

⁷² *Ibid* para 27.

⁷³ *Ibid* para 29.

⁷⁴ *Supra* note 58 para 25.

⁷⁵ This is subject to section 197(3)(b), which prohibits any terms and conditions agreed upon in terms of a collective agreement with the old employer, from being altered by the new employer.

⁷⁶ *Supra* note 3 para 34.

⁷⁷ C Bosch, ‘*The Employee's Right to Procedural Fairness in the Context of Transfers of Businesses*’ (2009) 30 *ILJ* 2253, at 2263.

amounts to a constructive dismissal, and provides an additional safeguard for employment security by linking section 197 to the unfair dismissal clauses. However, comparable to the wording of section 197(3), what is ‘substantially less favourable’ in section 186(1)(f) is open to interpretation, and might prove difficult to prove. Thus the provision could be abused by unscrupulous employees, and therefore might not serve the purpose the drafters wanted it to.

3. Chapter Two- The purpose of section 197

The analysis of section 197 above alludes to the intent behind its enactment, particularly when considered with regard to the preceding common law discussion. This section discusses the purpose of section 197, as set out by South African courts in further detail.

The purpose of the LRA is set out in section 1. The Act seeks to advance economic development, social justice, labour peace and the democratisation of the workplace. In furtherance of this purpose, the first object of the Act is to give effect to and regulate the fundamental rights conferred by section 23 of the Constitution.⁷⁸ Secondly, the Act must give effect to obligations incurred under the International Labour Organisation (ILO).⁷⁹ Thirdly, the Act must provide for collective bargaining, in promotion of, *inter alia*, employee participation in workplace decision-making,⁸⁰ and the effective resolution of labour disputes.

When analysing the purpose of the LRA, one of the most important considerations to take into account is the role of the LRA in respect of the constitutional right to fair labour practices. The South African Constitution has a unique feature in constitutionalising the general right to fair labour practices through section 23(1).⁸¹ However, this clause does not elaborate on what this right entails, leaving it to national legislation to give content to this right. The LRA was consequently enacted in order to give effect to this right.⁸² Section 23(1) of the Constitution

⁷⁸Section 1(a).

⁷⁹ Section 1(b).

⁸⁰ Section 1(d)(iii).

⁸¹ Supra note 3 para 33.

⁸² *Harsco Metals South Africa (Pty) Ltd and Another v Arcelormittal South Africa Ltd and others* (J2923/11) (2011) ZALCJHB 116, at para 12.

affords ‘everyone’ the right to fair labour practices; which means that employers and employees alike enjoy protection of this right under section 23 and the LRA. Consequently, the purpose of the LRA is to maintain a healthy balance between the inherent conflicts of interests that characterise the labour relations sector. The apparent incompatibility of employers’ and employees’ interests is only exacerbated in the business transfer context.⁸³ Therefore, the purpose of section 197 needs to be extrapolated from this state of affairs.

Thus there was a dichotomy regarding the purpose of section 197, prior to the CC judgement in *NEHAWU*.⁸⁴ One group argued that the main purpose of the section is to facilitate business transfers.⁸⁵ The second group argued that the purpose of section is to protect employment security in the event of transfer.⁸⁶ Consequently, the CC recognized that the core of business transfer disputes is a conflict between an employer’s interest in the profitability, or efficient disposal of the business; and the employee’s interest in job security.⁸⁷ Therefore the purpose of section 197 ‘lies somewhere in-between’ the two opposing interests.⁸⁸ The Court identified the dual purpose of section 197 as the medium that seeks to both facilitate sales of businesses as going concerns and protect the employment of the workers concerned.⁸⁹

3.1. The employer’s interests

It is trite to state that an employer’s interests in a business are commercially inclined. The average employer is predominantly concerned in the profitability, efficiency or survival of the business. On the other hand, an employer who fails to achieve any of the aforementioned goals, or seeks to pursue a different venture, would in the very least strive for the effective disposal of

⁸³ Supra note 3 para 31.

⁸⁴ Supra note 3 para 45.

⁸⁵ As found by the majority in *NEHAWU* in the LAC, at 312.

⁸⁶ As found by the minority of the LAC in *NEHAWU*, which drew authority from the contemporaneous LAC decision *Foodgro*, supra note 58.

⁸⁷ Supra note 3 para 52.

⁸⁸ *Ibid* para 45.

⁸⁹ *Ibid* para 53.

the business.⁹⁰ It would also be in a prospective new employer's interests for the sale of the business to be a swift and efficient process.⁹¹

Under the common law, this was not the case, as the old employer had to terminate the employment contracts and carry out retrenchment proceedings and make severance payments to the employees. If the employer sought to retain (part of) the workforce, lengthy employment contract novation negotiations would ensue.⁹² Therefore, the Explanatory Memorandum of the draft Labour Relations Bill stated that by providing for the automatic transfer of employees, section 197 would facilitate the employer's interests by removing the common law effects of business transfers,⁹³ which inhibited commercial transactions. The fact that Section 197 does not require the employee's consent prior to transfer also minimizes the potential tension and labour disputes which would ordinarily arise in business transfers.⁹⁴ New employers in skill, technology and machine –based industries are particularly benefitted, as they do not have to seek or train new employees. Old employers also do not have to (nor are they allowed to) resort to retrenchments in order to make a business appear more commercially-appealing to prospective buyers.

The role of section 197 in catering to employers' commercial interests was recently discussed in the Johannesburg High Court.⁹⁵ The Court held that the imposition of a restraint of trade agreement by a new employer soon after a business transfer did not infringe section 197(2) if such an agreement was non-existent with the previous employer.⁹⁶ The inclusion of section 197(3)(a) of the LRA allows for a new employer to unilaterally change the terms and conditions of the employment contract if they are 'on the whole note less favourable' to employees than the previous employment contract.⁹⁷ Therefore the Mbha J stated that section 197(2) must be read

⁹⁰ Ibid para 52.

⁹¹ Supra note 82 para 12.

⁹² See Chapter Two.

⁹³ The effects ranged from retrenchments- which imposed onerous procedural obligations; the payment of severance benefits; and other escalated costs such as compensation orders.

⁹⁴ Supra note 3 para 53.

⁹⁵ Supra note 70.

⁹⁶ Ibid para 29.

⁹⁷ See footnote 75.

with section 197(3)(a), which allows employers to protect their commercial interests by altering the terms and conditions of transferred employees' contracts.⁹⁸ The Court also held that imposing a restraint of trade agreement after transfer is permissible, given that *in casu*, the employee 'consensually and voluntarily' entered a fresh agreement regulating their rights and obligations.⁹⁹ This dictum does raise potential issues however, as the extent of voluntariness on the employees' part is questionable. This will be discussed below.¹⁰⁰ However, the important principle raised in this judgment is that the purpose of section 197 is not to thwart the employer's commercial interests, and as a matter of fact, provides for the protection thereof.

3.2. The employee's interests

One cannot sufficiently articulate the importance of protecting employment security without analysing the context within which this need exists. Although section 197 was drawn from foreign law, the effects of South Africa's political and social history on labour relations today are unique.¹⁰¹ Therefore the purpose of the provision needs to be analysed with cognisance of the vulnerable position of the employee in South Africa.

Racially exclusive legislation,¹⁰² enacted by the apartheid government meant that black employees were predominantly unskilled labourers who did not enjoy any statutory entitlement to employment security or fair labour practices.¹⁰³ Even upon the abolishment of the racial dichotomy in labour relations legislation,¹⁰⁴ the social effects of the apartheid government remained.¹⁰⁵ Unskilled labourers were predominantly uneducated black people from

⁹⁸ Supra note 70 para 29.

⁹⁹ In terms of section 197(6).

¹⁰⁰ See note page 25.

¹⁰¹ Considerations of brevity and the scope of this paper does not allow for a detailed discussion on the historical development of labour relations.

¹⁰² The Industrial Conciliation Act 11 of 1924 excluded black people from the definition of an 'employee'.

¹⁰³ D Du Toit et al, *Labour Relations Law- A Comprehensive Guide*, 5th ed, Lexis Nexis Butterworths 2006, at 9.

¹⁰⁴ The segregation of black and white workers in labour legislation was eradicated in a series of Amendments- namely the Labour Relations Amendment Acts 57 of 1981, 51 of 1982 and 2 of 1983.

¹⁰⁵ In the African National Congress policy document '*A basic guide to the Reconstruction and Development Programme*' of 1994, some of the deleterious effects of the apartheid government were listed. This list includes lack

disadvantaged backgrounds, who were desperate for employment in a climate where there was a scarcity of job opportunities.¹⁰⁶ Employees are therefore easily replaceable, as the number of job-seekers far outweighs the job opportunities available.¹⁰⁷ Therefore, employers in South Africa wield a lopsided amount of economic power due to the inequality that characterises employment relationships in developing economies.¹⁰⁸

It is a well-established socio-economic fact that an individual employer represents an accumulation of material and human resources. Therefore, in this context, an employer is a ‘collective power’.¹⁰⁹ Thus, the employment relationship is typically a relationship between a bearer of power and one who is not a bearer of power.¹¹⁰ Therefore, the CC held in *Sidumo & another v Rustenburg Platinum Mines Ltd & others* that the LRA serves as a countervailing force to counteract the inequality of bargaining power inherent in the employment relationship.¹¹¹ The LRA is thus an example of ‘protective legislation’, which seeks to maintain a balance between those who yield an abundance of power; and those who have none by infusing law into a relationship of command and subordination. It is in this context that it must be understood.¹¹²

Prior to the enactment of section 197 of the LRA, the characteristically unenviable position of employees was worsened when business transfers were regulated by the common law. As discussed above,¹¹³ there was no employment security because the default consequence of a business transfer was the termination of employment contracts. It is in this light that the purpose

of education amongst black people; high unemployment and under-employment rates; the exclusion of black people from economic control and the underpayment of (mostly black)workers.

¹⁰⁶ See M Brassey, ‘*Fixing the Laws that Govern the Labour Market*’ (2012) 33 ILJ 1, at 2.

¹⁰⁷ According to a calculation made by the Project for Statistics on Living Standards and Development: *South African Rich & Poor: Baseline Household Statistics*, 1994, the unemployment rate was an estimated 30% in 1994. According to Statistics South Africa, the 2013 percentage of unemployed South Africans is 25.6%.

¹⁰⁸ *Sidumo & another v Rustenburg Platinum Mines Ltd & others* (2007) 28 ILJ 2405 (CC), at para 72.

¹⁰⁹ Davies & Freedland, ‘*Kahn-Freund's Labour and the Law*’, Hamlyn Lecture Series 3rd ed, Stevens & Sons London, 1983, at 17.

¹¹⁰ *Ibid* at 18.

¹¹¹ *Supra* note 108 74.

¹¹² Davies & Friedland *op cit* note 109 at 18.

¹¹³ See Chapter One.

of section 197 in protecting employees' interests needs to be construed. Consequently, one of the most drastic effects of section 197 is the link it bears to the automatically unfair dismissals clause in the LRA. Section 187(1)(g) states that a dismissal is automatically unfair if the employer dismisses an employee because of a transfer, 'or a reason related to a transfer, contemplated in section 197 or 197A.' The phrase 'a reason related to a transfer' is wide enough to encompass a wide range of scenarios. This clearly seeks to overturn the common law position, as well as to avoid the use of 'sham transactions' to deprive employees of their statutory rights.¹¹⁴

Even after the enactment of section 197, it is a social reality that employees are still relatively powerless against their employers in the bargaining arena. Therefore it is worrying when courts ascribe epithets such as 'consensual and voluntary' to decisions made by employees in a transfer context. For example, section 197(3) allows for the unilateral change of terms and conditions of the employment contract by a new employer subsequent to transfer. However, the Legislature counterbalanced this right by imposing a fairness requirement, that the changes cannot be on the whole less favourable to the employee. Therefore, the right to fair labour practices is not compromised. Furthermore, in terms of section 186(1)(f), it amounts to an unfair dismissal if an employee terminates an employment contract because the new employer provided him or her with conditions that are substantially less favourable to the employee in comparison to those provided by the old employer. Hence the CC has stated that the proper approach to the construction of section 197 is to meet the purpose of protecting workers against loss of employment in substance as well as in form.¹¹⁵

3.3. Employers versus employees: Whose interests prevail?

The dictum by the CC in *NEHAWU* on the twofold purpose of section 197 may lead to the question: are the interests of employers and employees to be protected equally by the courts? In response to this question, some scholars firmly assert that the fact that section 197 is dual in purpose does not mean that the interests of the employers and the employees should be weighed

¹¹⁴ In *Kebeni & others v Cementile Products*, supra note 26, the old employer used a sham business transfer in order to dismiss and selectively re-employ its workforce after transfer to the new employer was effected.

¹¹⁵ Supra note 65 para 39.

equally.¹¹⁶ This assertion is implied by the statement by Ngcobo J that it cannot be gainsaid that, ‘an important purpose of section 197 is to protect the workers against the loss of employment in the event of a transfer of a business.’¹¹⁷ Furthermore the judge held that this conclusion is strengthened, ‘not only by the effect of the section, but also by the very fact that the section was inserted in a chapter that deals with unfair dismissal.’¹¹⁸ The Court also drew authority from international legislation. The preamble of the EEC Directive 77/187¹¹⁹ states that the Directive provides for the ‘protection of employees in the event of a change of employer, in particular, to ensure that their rights are safeguarded.’¹²⁰ Therefore there is a general recognition that employee rights deserve stronger protection in some circumstances; and in the case of business restructuring, employees are usually the vulnerable parties.

The LAC in *Aviation Union*¹²¹ interpreted the twofold nature of section 197 as defined by the CC in such a way that effectively narrowed the scope of the facilitation of business transfers. The Court held that the role that section 197 plays in facilitating business transfers must be construed as meaning that the new employer would not have to look for workers who would do the work; nor will it have to train new recruits for work that they have not done before. Section 197 therefore assists new employers by allowing for the automatic transfer of employees who have been doing the work and have experience in the work. However, the rights of employers should not be undermined or disregarded, as the LRA involves a ‘complex balancing exercise of the rights of employers and employees.’¹²² Therefore, the mandate on courts to protect the vulnerability of employees needs to be construed in this light.

¹¹⁶ C Bosch op cit note 49 at 927.

¹¹⁷ Supra note 3 at para 46.

¹¹⁸ Ibid.

¹¹⁹ Supra note 41 at 77/187.

¹²⁰ Supra note 3 para 48.

¹²¹ *Aviation Union of SA obo Barnes & others v SA Airways (Pty) Ltd & others* (2010) 1 BLLR 14 (LAC), at para 20.

¹²² Cheadle et al, ‘*South African Constitutional Law: The Bill of Rights*’ (2002), at 18-15.

4. Chapter Three- Interpreting section 197

The ‘golden rule’ of statutory interpretation¹²³ is that the ordinary meaning of words should be given effect to when interpreting a statutory provision. This paper attempts to illustrate how section 197 is quintessentially ambiguous,¹²⁴ which raises questions of how the golden rule applies, given the problematic wording of the section. Thus this chapter discusses how South African courts have developed the principles of statutory interpretation in situations where the golden rule yields problematic results. The question of how the enactment of the 1993 Constitution affects the manner in which section 197 should be interpreted is also addressed.

4.1. Statutory interpretation

The *locus classicus* for statutory interpretation in South Africa is *Venter v R*,¹²⁵ where the Court held that the aim of interpretation is to ascertain the Legislature’s intention from the language of the statute.¹²⁶ The Court held that to garner the Legislature’s intent, one must:

‘take the language of the instrument, or of the relevant portion of the instrument, as a whole; and, when the words are clear and unambiguous, place upon them their grammatical construction and give them their ordinary effect.’¹²⁷

The Court nonetheless acknowledged that ‘no matter how carefully words are chosen’, language is inherently difficult to define precisely. Therefore, as an exception- one can depart from the plain meaning of words in a statute if giving them their ordinary meaning, ‘would lead to an absurdity so glaring that it could never have been contemplated by the Legislature.’¹²⁸ The SCA reaffirmed this dictum in *Ngcobo and others v Salimba CC; Ngcobo v Van Rensburg*.¹²⁹ The majority judgment by Oliver JA did, however, develop the golden rule to the extent that a

¹²³ This expression was used in *Venter v R* 1907 TS 910, at 913.

¹²⁴ See Chapters Four and Five.

¹²⁵ 1907 TS 910, at 913.

¹²⁶ *Ibid* at 913.

¹²⁷ *Ibid*.

¹²⁸ *Ibid* at 915.

¹²⁹ 1999 (2) SA 1057 (SCA).

provision should be read in its context¹³⁰ and with due regard to the objects of the statute, where the ordinary meaning yields absurd results.¹³¹

Olivier JA added that the golden rule could be departed from, if the ordinary meaning resulted not only in absurd results, but also where it would render the provision unconstitutional or contrary to the spirit, purport and objects of the Bill of Rights in terms of section 39(2) of the Constitution.¹³² Drawing from this judgment, de Ville comments that principles of statutory interpretation should thus be derived from the Constitution.¹³³ Therefore, interpretation should shift from the notion of searching for the Legislature's intention, to a notion of 'an enforcement of constitutional values.'¹³⁴ This is particularly relevant when interpreting section 197(1)(b) in the outsourcing context, where the meaning of the word 'by' has been intensely debated.¹³⁵ No argument has been raised in this debate that the reliance on the ordinary meaning of the word 'by' would result in an absurdity. It has however, been argued that the necessity for a transfer to be carried out 'by' an old employer in section 197(1)(b) may fall short of the constitutional mandate placed on the LRA to protect the employee's right to fair labour practices.¹³⁶ And so, it is submitted that section 197 cannot be adequately interpreted without contextualising the section according to its purpose and role in the new constitutional dispensation.

¹³⁰ 'Context' in this regard may include the social, political and economic context, as well as the context of the case at hand. An interpreter may also analyse a provision against other statutes in *pari materia*, and the 'mischief' that the statute was enacted to remedy. See *Jaga v Dönges, NO and Another; Bhana v Dönges, NO and Another* 1950 (4) SA 653 (A), at 664

¹³¹ *Supra* note 129 para 11.

¹³² *Ibid.*

¹³³ JR. de Ville, '*Constitutional and Statutory Interpretation*' Interdoc Consultants (Pty) Ltd, Cape Town 2000, at 51, at 60.

¹³⁴ *Ibid* at 60.

¹³⁵ This debate is discussed in full in Chapter 5.

¹³⁶ See C Bosch *op cit* note 49 at 931. This will also be expounded on in Chapter Five.

4.2. Linking the LRA and the Constitution

As discussed above,¹³⁷ the purpose of the LRA is to give effect to the constitutional right to fair labour practices. The conceptual nexus between section 23 of the Constitution and the LRA must therefore be borne in mind when the question of how to interpret any provision within the Act arises.¹³⁸ Accordingly, the CC pronounced on the impact of the Constitution on the interpretation of the LRA.

The *NEHAWU* decision was handed down at a time when the correct interpretation of section 197 was highly contested.¹³⁹ With this in mind Ngcobo J stated that the question regarding the correct interpretation of section 197 was a constitutional issue.¹⁴⁰ The Court reaffirmed that the LRA was enacted to promote section 23 of the Constitution, which is of great importance in the interpretation context. For this reason, Ngcobo J cautioned that the interpretation of the LRA must be carried out in a manner consistent with that purpose.¹⁴¹ One of the core principles raised in this judgment was therefore, whenever the provisions of the LRA are in dispute, the statute must be ‘purposively construed’ in light of its relationship with section 23 of the Constitution.¹⁴² A purposive interpretation moves away from the ‘traditional’ approach to interpretation of statutes, where the ordinary and literal meaning of the statute was the main interpretive tool.¹⁴³

The CC revisited the question of the correct interpretation of the LRA shortly after *NEHAWU*. The Court elaborated on what a purposive interpretation would entail in *NUMSA & others v Bader Bop (Pty) Ltd & another*.¹⁴⁴ The Court, *per* O’Regan J held that a purposive interpretation of the LRA requires due regard being given to the purpose of the Act, as set out in section 1.¹⁴⁵ The interpretations clause in the LRA instructs that whenever the Act is interpreted, effect must

¹³⁷ See Chapter Two.

¹³⁸ C Todd et al op cit note 2 at 14.

¹³⁹ Ibid at 21.

¹⁴⁰ Supra note 3 para 14.

¹⁴¹ Ibid.

¹⁴² Ibid para 16.

¹⁴³ JR de Ville op cit note 113 at 244.

¹⁴⁴ (2003) 24 ILJ 305 (CC).

¹⁴⁵ Ibid para 26.

be given to its primary objects.¹⁴⁶ Furthermore the interpretation must be in compliance with the Constitution,¹⁴⁷ as well as the public international law obligations incurred by South Africa.¹⁴⁸ With regard to the Constitutional aspect of interpreting the LRA, O'Regan J held that the interpretations clause in section 39(1) of the Constitution must be given effect to. Therefore, when interpreting the LRA the promotion of values which underlie 'an open and democratic society based on human dignity, equality and freedom' is imperative.¹⁴⁹ Furthermore, courts 'must consider international law,'¹⁵⁰ and may consider foreign law.¹⁵¹

The Court also held that if the LRA is capable of a broad interpretation, which does not limit any other fundamental human rights, that interpretation should be preferred.¹⁵² The principles set in *Bader Bop* not only served as a guideline to the correct interpretation of the LRA; they also helped to bridge the gap between the Constitution and the LRA. The LRA therefore cannot be interpreted in a vacuum, given the role it plays in South Africa's constitutional democracy. However, the Court also held that due deference must be given to legislative intent if the intention is to limit certain rights on a justifiable basis.¹⁵³ This finding is particularly important in reference to section 197, which potentially limits the freedom of either employees to consent to transfer, or of employers to choose who to employ.

4.3. The role of international and foreign law

In *NEHAWU*, the CC held that in interpreting and giving content to the LRA, courts have to seek guidance from domestic and international experience.¹⁵⁴ As a ratified member State of the ILO, South African Courts are explicitly mandated by the LRA to interpret the Act in compliance with

¹⁴⁶ Section 3(a).

¹⁴⁷ Section 3(b).

¹⁴⁸ Section 3(c).

¹⁴⁹ Section 39(1)(a).

¹⁵⁰ Section 39(1)(b).

¹⁵¹ Section 39(1)(c).

¹⁵² *Supra* note 144 para 37.

¹⁵³ *Ibid.*

¹⁵⁴ *Supra* note 3 para 34.

the obligations incurred from this membership.¹⁵⁵ However, the international guidelines which regulate business transfers are not found in the ILO Conventions. Section 197 was drawn from English and European law,¹⁵⁶ whose principles South Africa has no obligation to apply.¹⁵⁷ However, the interpretational guidelines of section 39 of the Constitution need to be borne in mind, especially when there is a constitutional right at stake. Nevertheless, section 197 was evidently drafted with the principles set in the European business transfer statutes in mind.¹⁵⁸ Therefore, in the pursuit of applying a purposive interpretation to the LRA, foreign law should be given regard in order to give substance to issues that need clarification.¹⁵⁹ For example, the following interpretation of the Acquired Rights Directive¹⁶⁰ given by the ECJ is a useful summation of how to interpret business transfer provisions purposively.

‘The objective of the Directive is to ensure as far as possible the continuation without change of the contract of employment or the employment relationship with the transferee in order to avoid the workers concerned being placed in a less favourable position by reason of the transfer alone.’¹⁶¹

The South African courts have accordingly followed suit, relying extensively on the interpretation of English and European statutes to give content to section 197.¹⁶²

Despite the important role that foreign law plays in interpreting section 197, resorting to comparative analyses has been described as ‘dangerous’, in the absence of sufficient awareness of the differences in language, context and the purpose of section 197 to its foreign

¹⁵⁵ Section 3(c).

¹⁵⁶ In the form of the UK TUPE Regulations and the EEC Directive 77/187.

¹⁵⁷ In this regard, Landman MA A in *Ntuli v Hazelmores* supra, held that the principle of equity did not require the Court to adopt the EEC Directive’s principles, at 719.

¹⁵⁸ C Todd et al op cit note 3 at 23.

¹⁵⁹ An example of this approach is found in the dictum in *Schutte & others v Powerplus Performance (Pty) Ltd & another* (1999) 20 ILJ 655 (LC). The Court held that decisions grappling with the interpretation of business transfer law by the European Court of Justice (ECJ) and UK Courts would be useful in guiding the Court through ‘unchartered waters’.

¹⁶⁰ Directive 2001/23/EC of March 2001 (which replaced Directive 77/187/EEC of 1977).

¹⁶¹ *Landsorganisationene i Danmark v Ny Molle Kro* 1989 IRLR 37, at para 29.

¹⁶² See *Foodgro, A Division Leisuren Ltd v Keil* supra note 58; *Schutte & others v Powerplus Performance* supra note 159; *NEHAWU v University of Cape Town and Others* supra note 3.

counterparts.¹⁶³ Therefore the value of foreign law should not be overstated. The courts need to bear in mind that although similar to the European Directive, section 197 is not cast in identical terms.¹⁶⁴ It would be a ‘fundamental error’ to elevate foreign jurisprudence to the status of a clear guide to the content of our law.¹⁶⁵ Kahn-Freund spoke at length about the need to trace a hypothetical line, ‘which separates the use of the comparative method in lawmaking from its misuse.’¹⁶⁶ He commented that it is only ‘in the most exceptional cases that the institutions of one country could serve those of another at all.’¹⁶⁷ Furthermore, Kahn-Freund argues that the unique nature of each country’s political regime stands as the biggest obstacle to ‘legal transplantation’.¹⁶⁸ Therefore, it is submitted that courts should apply foreign law as an advisory mechanism that would facilitate a purposive interpretation of section 197. Used in this manner, full effect can be given to the purpose of section 197 in light of the stated need for employment protection in European and English law.

5. Chapter Four- The application of section 197

The adoption of a purposive and encompassing interpretation of section 197 is a crucial element in ensuring adequate protection of employees in business transfers. However, this has proven to be an idealistic notion, as various obstacles have arisen in the section 197 jurisprudence, and have beleaguered courts attempting to apply section 197 to a given set of facts. The discussion below illustrates the various challenges presented by the applicability inquiry of section 197. Three factors trigger the application of section 197. There must be an existing business (or part thereof); a transfer of the business by one employer to another; and a transfer carried out as a going concern.¹⁶⁹ The LC has cautioned that the questions of whether there has been a transfer of a ‘business’ and whether the transfer was carried out as a going concern are two separate

¹⁶³ Wallis, ‘Is Outsourcing in? An Ongoing Concern’ (2006) 27 ILJ 1, at 8.

¹⁶⁴ Supra note 159 para 32.

¹⁶⁵ M Wallis op cit note 163 at 8.

¹⁶⁶ Kahn-Freund, ‘*On Uses and Misuses of Comparative Law*’, *The Modern Law Review*, Vol. 37, No. 1 (Jan., 1974), pp. 1-27, at 6.

¹⁶⁷ *ibid*

¹⁶⁸ ‘Legal transplantation’ stands for the adoption by one country of foreign legal institutions or mechanisms. At 8.

¹⁶⁹ See Introduction at 7.

questions, and to confuse or conflate them could possibly defeat the purpose of section 197.¹⁷⁰ Therefore, the discussion on the applicability of section 197 below will be structured accordingly.¹⁷¹

5.1. What is a ‘business’ under section 197?

Todd et al have suggested that there are three reasons why the identification of an entity as a business for the purposes of section 197 is important.¹⁷² First, as stated in section 197(1)(a), the section may only be applied in cases where an entity constitutes a business as defined. Secondly, it is only upon the proper delineation of the entity as a business that can one establish which employees are connected and therefore, affected by an impending business transfer. Thirdly, the factual inquiry of whether there has been a transfer as a going concern can only be answered by an analysis of the components of a particular business. Identifying what amounts to a business is therefore important, although courts tend to skim over analysing whether an entity constitutes a business in a fair amount of cases.¹⁷³ Therefore, the case law does not give an adequately comprehensive guideline to what a business is. Rather, the focus is shifted on what a business is *not*.¹⁷⁴

Section 197(1)(a) does not assist in clarifying what a business is by defining the term. Instead, it states that a business *includes*,¹⁷⁵ ‘the whole or a part of any business, trade, undertaking or service.’ This imprecise definition has been taken to indicate the legislative intent for the section

¹⁷⁰ Supra note 16 para 38.

¹⁷¹ The requirement that the transfer be carried out by an old employer to a new employer will be discussed in detail in Chapter 5, in regard to the applicability of section 197 to outsourcing contracts.

¹⁷² Ibid Todd et al, at 32.

¹⁷³ The jurisprudence on business transfers shows a trend by courts to simply state that section 197 was drafted with the intention to apply it to as many cases as possible. (See *Aviation Union of SA & another v SA Airways (Pty) Ltd & others* (2012) 3 BLLR 211 (CC) at para 45. Some courts just make the assumption that it is a business and proceed to the transfer inquiry (See *NEHAWU v University of Cape Town and Others* 2003 (2) BCLR 154 (CC). Ngcobo J did not examine whether the (outsourced) entity being transferred was a business, but based the factual inquiry on the going concern question).

¹⁷⁴ This is particularly the case in service-based or outsourcing cases, which will be discussed in detail in the next chapter.

¹⁷⁵ The use of the word ‘includes’ means that the list in section 197(1)(a) is not limited to the listed items.

to have a wide embrace.¹⁷⁶ The wide scope of subsection (1)(a) is also supported by the fact that ‘any part of’ the listed items can constitute a business for the purposes of section 197. Furthermore, the use of the words ‘undertaking’ and ‘service’ indicates that section 197 is applicable to structures that fall outside of income-generating entities.¹⁷⁷ The CC has held that the section applies to, ‘any business provided that the other requirements are met. The aim is to cast the net as wide as possible.’¹⁷⁸

Identifying an entity as a business is a fairly straightforward process when an entire business is transferred as a going concern. But the enquiry is complicated and requires deeper analysis when only a part of a business is transferred.¹⁷⁹ It becomes necessary to analyse whether the part being transferred has features that would sufficiently constitute a business for section 197 purposes.¹⁸⁰ There is no statutory guidance on what these features are or should be, although case law has attempted to flesh out the defining features of a business. Courts consequently have to examine the factual matrix of each case to establish whether or not an entity can be identified as a business for the purposes of the section.¹⁸¹

As a point of departure, a business is typically identified by the existence of certain features, such as goodwill, operational resources or a workforce.¹⁸² There can be no closed list of features to identify a business;¹⁸³ giving courts sufficient room to scrutinise entities in each case and reach a conclusion. However, the composition of a business is a dynamic concept, which changes according to modern developments, and may possess considerably less features traditionally used to identify a business. In *Schutte v Powerplus Performance (Pty) Ltd &*

¹⁷⁶ C Bosch op cit note 45, at 848.

¹⁷⁷ C Todd et al op cit note 2 at 33.

¹⁷⁸ Supra note 65 para 45.

¹⁷⁹ C Bosch cit note 49 at 931.

¹⁸⁰ C Todd et al op cit note 2 at 33

¹⁸¹ *SAMWU v Rand Airport Management Co (Pty) Ltd & others* (2002) 23 ILJ 2304 (LC), at 2310.

¹⁸² *Grinpal Energy Management Services (Pty) Ltd v City Power Johannesburg (Pty) Ltd & others* (2013) 34 ILJ 905 (LC), at para 13.

¹⁸³ Bosch provides a comprehensive list of components that may be used to determine whether an entity is a business. This includes tangible and intangible assets, management staff, premises, a business name, contracts with particular clients, the activity performed and operating methods. C Todd et al op cit note 2 at 27.

another,¹⁸⁴ Seady J described an entity that is ‘severable from the entire business’ as capable of being a business for section 197 purposes.¹⁸⁵ This ‘entity’ must therefore have sufficiently linked components that are structured in a way that makes them identifiable as such.¹⁸⁶ The Court in *Schutte* therefore followed the guidelines set by a landmark ECJ case on transfers of undertakings,¹⁸⁷ which described an entity as ‘an organised grouping of persons and assets facilitating the exercise of an economic activity, which pursues a specific objective.’¹⁸⁸ Wallis succinctly states that section 197 comes into play whenever there is the transfer of, ‘an *identifiable component or unit* of a business, be it a division, a branch, a department, a store or a production unit.’¹⁸⁹ The ECJ has also held that the activity carried out by the entity may still be identified as a business, even if it is only ancillary to the main object of the business.¹⁹⁰ Thus the entity need not be profit-generating.¹⁹¹

The discussion above raises the general principles which can be used in identifying a business for purposes of section 197. These guidelines are particularly necessary when attempting to apply section 197 to outsourcing contracts. In light of the purpose of section 197 as discussed, it is submitted that these guidelines should be used as a means to include rather than restrict non-traditional forms of business from the scope of the provision. An analysis of whether South African courts have taken these considerations into account when developing the concept of employee protection under section 197 will consequently ensue in the next chapter.

5.2. What constitutes a transfer as a going concern?

The requirement of the transfer of a business as a going concern as set by section 197(1)(b) is arguably the most contentious clause that courts have sought to interpret and apply in business

¹⁸⁴ Supra note 159.

¹⁸⁵ Supra note 159 at para 43.

¹⁸⁶ C Todd et al op cit note 2at 33.

¹⁸⁷ *Suzen v Zehnacker Gebäudereinigung GmbH Krankenhausservice* (1997) IRLR 255.

¹⁸⁸ Ibid para 13.

¹⁸⁹ Wallis, ‘*Section 197 is the Medium: What is the Message?*’ (2000) 21 ILJ 1, at 5, (italics added for emphasis).

¹⁹⁰ *Allen v Amalgamated Construction Co Ltd* (2000) IRLR 119 (ECJ), found in Todd et al, supra, at 33.

¹⁹¹ Bosch, ‘*Of Business Parts and Human Stock: Some Reflections on Section 197(1)(a) of the Labour Relations Act*’ (2004) 25 ILJ 1865, at 1874.

transfer litigation. However, the sweeping consensus in South Africa is that, upon satisfying the requirements set in section 197(1)(b), the application of the entire section is activated; thus it is treated as the trigger-mechanism for section 197.¹⁹² The discussion below will separate the notions of ‘transfers’ and what constitutes a ‘going concern’ for the sake of clarity.

5.2.1. Which transactions amount to a transfer?

The complete lack of definition or guidance by the Legislature on which legal transactions constitute a transfer can be described as a mixed blessing. On one hand, the undefined concept of a transfer allows for a liberal and purposive interpretation of the word, providing for a wide range of transactions (that may have been excluded by definition) to satisfy the requirements set by section 197. On the other hand, the lack of definition has resulted in unnecessary litigation, where parties contest whether a certain transaction amounts to a transfer. In *f173*, the LC was presented with the herculean task of interpreting section 197 for the first time. The Court set a helpful precedent that has been widely accepted in subsequent business transfer cases. There was no sale of the business being transferred *in casu*;¹⁹³ therefore the question was whether a transaction other than the sale of a business could qualify as a transfer under section 197.¹⁹⁴ Seady AJ held that the application of section 197 was not limited to sales of businesses alone.¹⁹⁵ A transfer under section 197 can be a range of legal transactions such as a merger, takeover, restructuring within a company, and an exchange of assets or a donation.¹⁹⁶ Drawing from the interpretation of article 1(1) of Directive 77/187/EEC¹⁹⁷ by the ECJ, Seady AJ held that an analysis of the substance rather than the form of the transaction is necessary when determining whether a transfer has taken place.¹⁹⁸

¹⁹² Supra note 3 para 43.

¹⁹³ Supra note 159 para 671.

¹⁹⁴ The contested transfer was the outsourcing of vehicle servicing duties by Super Group to Powerplus Performance (Pty) Ltd.

¹⁹⁵ Ibid at 671.

¹⁹⁶ Ibid.

¹⁹⁷ Ibid note 41.

¹⁹⁸ Supra note 41 at 665.

The finding in *Schutte* was endorsed in by the CC in *NEHAWU*,¹⁹⁹ and has essentially been accepted as the cornerstone of applying section 197 to a set of facts. In *Aviation Union*,²⁰⁰ the CC followed this line of reasoning and rejected the dependence on the label of the transaction effecting transfer by the court *a quo*.²⁰¹ The Court held that in identifying whether there has been a transfer, one must determine this with reference to the objective facts of the case.²⁰² The substantive interpretation and application of a business transfer is particularly necessary in cases where employers attempt to side-step the obligations imposed by section 197 by transferring the business in a transaction that they claim falls outside of the scope of the provision. Therefore, it is submitted that courts should avoid categorising transactions into compartments that either constitute business transfers or do not, as this would be in conflict with the stated purpose of the section in respect of employee protection.

It has been suggested that what is ultimately important in the applicability inquiry of section 197 is that the transaction in question has the effect of transferring a business as a going concern- and *how* that occurs is of no real significance.²⁰³ Once this view is adopted, the requirement for ownership of a business to be transferred from the old employer to the new employer for there to be a transfer will be eliminated by necessary implication. Furthermore, the requirement for a contractual link between the transferor and the transferee will also be eliminated.²⁰⁴

However, at the other end of the spectrum, some limits should be placed on the scope of the section by courts in order prevent unnecessary litigation, and to avoid an ‘opening of the floodgates’ effect.²⁰⁵ Employers should not also be over-burdened with the obligation to take on the workforce of a previous employer where the facts of the case do or should not amount to a transfer of a business. Of course, such limits can only be established and developed with time by

¹⁹⁹ Supra note 3 para 56.

²⁰⁰ Supra note 65 para 44.

²⁰¹ The Supreme Court of Appeal (SCA).

²⁰² Supra note 3 para 48.

²⁰³ C Todd et al op cit note 2 at 25.

²⁰⁴ Ibid.

²⁰⁵ Whereby employees, trade unions or any other interested parties would argue that section 197 applies to any or every legal transaction within the workplace.

the courts, as legislative exclusions usually have the adverse effect of formal interpretation and rigid application, to the detriment of the excluded groups. For example, in the recently decided case of *Long v Prism Holdings Ltd and another*,²⁰⁶ the LC held that the acquisition of shares of one company by another does not constitute a ‘takeover’ of business as a going concern.²⁰⁷ Citing Todd et al,²⁰⁸ the Court held that it is clear from the wording of section 197 that the old employer and the new employer must be two separate entities.²⁰⁹ In such cases, *control* is shifted but, in light of the concept of separate legal identity, the legal identity of the employer remains the same.²¹⁰ Therefore, the principles set in *Schutte*²¹¹ need to be borne in mind each time the applicability of section 197 is raised against a set of facts.

5.2.2. Establishing a ‘going concern’ transfer

One can justifiably attribute the inclusion of the words ‘as a going concern’ as a prominent factor that hinders the efficacy of section 197. The question of what makes a transfer a going concern has not, and cannot be answered definitively. The enquiry will always have to be fact-dependent, meaning that disputes surrounding section 197 will often require litigation. The applicability of the section turns on this clause, which can only be dealt with on a case-by-case basis. Accordingly, there is now an array of available tests, formulated by judges in order to determine whether there has been a going concern transfer. The discussion below will consider some of these tests, and whether they sufficiently provide for the balanced and purposive application of section 197.

Speaking for the majority of the CC in *NEHAWU*,²¹² Ngcobo J held that because ‘going concern’ is not defined in the LRA, it must be given its ordinary meaning, unless the context indicates otherwise.²¹³ In attempting to comprehend what the ordinary meaning of a going concern entails,

²⁰⁶ 2013 (1) Sa 533 (LAC).

²⁰⁷ Ibid para 34.

²⁰⁸ C Todd et al op cit note 2.

²⁰⁹ Supra note 206 para 33.

²¹⁰ Emphasis added..

²¹¹ See footnote 193.

²¹² Ibid

²¹³ Supra note 3 para 56.

the LAC in *SAMWU v Rand Airport Management Co (Pty) Ltd & others*²¹⁴ stated that the starting point of any going concern enquiry must be the minority judgment handed down by Zondo JP in the LAC leg of the *NEHAWU v University of Cape Town* litigation.²¹⁵ The judge held that the going concern inquiry is an objective determination, where the *ipse dixit* of the old employer and new employer cannot be conclusive.²¹⁶ A court faced with a business transfer would therefore have to look at the range of factors, and whether they point towards a going concern. An analysis of what would happen to factors such as the goodwill of the business; the stock-in-trade; the premises; contracts with clients; the workforce; the assets of the business, and the daily operation of the business after transfer is necessary.²¹⁷ However, the absence of any one of these factors should not be construed as destroying the status of the transfer as one of a going concern.

The finding by the LAC in *NEHAWU* reaffirmed the *Schutte* judgment,²¹⁸ where Seady AJ held that when attempting to evaluate the assets that typically constitute traditional businesses, one must appreciate that what comprises a business has changed greatly. Thus an approach that is cognitive of these changes should be adopted.²¹⁹ For example, in the service sector the assets of businesses are often only in the form of intellectual property and intangible assets. In modern business structures, a strict application of the going concern test would essentially demarcate a line between asset and non-asset based businesses; with the latter businesses being effectively excluded from the protection offered by section 197. This is clearly an issue in attempting to apply section 197 in outsourcing cases. It is accordingly submitted that the various examples of factors that point towards a going concern transfer given by courts and scholars should be construed as nothing more than guidelines that can assist the interpretation of the going concern inquiry.

²¹⁴ (2005) 26 ILJ 67 (LAC), at para 21.

²¹⁵ Supra note 62 para 64.

²¹⁶ He added that this does not mean that the intentions of the parties are irrelevant, however.

²¹⁷ Ibid,

²¹⁸ Supra note 159.

²¹⁹ Ibid para 40.

In *NEHAWU*,²²⁰ the CC reiterated that the list of factors provided were neither exhaustive nor decisive in effect.²²¹ However, the ‘*NEHAWU* test’ has been widely accepted in subsequent business transfer cases, and serves as a helpful guideline in determining the applicability of section 197 to a given scenario. The test was set out by Ngcobo J as follows:

‘In deciding whether a business has been transferred as a going concern, regard must be had to the substance and not the form of the transaction. 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.’²²²

The *NEHAWU* test has however been supplemented in circumstances where its application may yield inconclusive results. Thus, the ECJ judgment in *Spijkers v Gebroeders Benedik Abattoir & Alfred Benedik En Zonen*²²³ has been accepted in South African courts as authority on the interpretation of a going concern in business transfer legislation. The European Court of Justice held that a decisive criterion for establishing the existence of a going concern transfer is whether the entity in question retains its identity after transfer.²²⁴ Furthermore, the distinguishing feature should not be whether assets have been transferred, but whether what has been transferred is an economic entity which is still in existence, with the same economic or similar activities.²²⁵ This test has been referred to extensively and has helped to develop business transfer law in South Africa.

However, in *Harsco Metals South Africa (Pty) Ltd and Another v Arcelormittal South Africa Ltd and Others*,²²⁶ the LAC highlighted the difficulty in identifying an ‘economic entity’ in some businesses. Accordingly, the efficacy of the economic entity test was questioned when applied to

²²⁰ Supra note 3.

²²¹ Ibid para 56.

²²² Ibid.

²²³ (1986) ECR 119.

²²⁴ Ibid para 11.

²²⁵ Ibid para 12.

²²⁶ Supra note 82.

businesses that do not have discernable assets or employees.²²⁷ The LAC thus held that when establishing whether the transferred business retains its identity after transfer, the primary criterion is the nature of the business.²²⁸ This is because the nature of the business indicates the weight that needs to be attached to the factors that would point towards the identity of the business. Similarly in *Spijkers*, the ECJ held that to establish whether the transfer is a going concern or not, the full range of the circumstances of the transaction in question need to be taken into consideration.²²⁹ Amongst these circumstances would be the type of undertaking or business in question.²³⁰

The guidelines above have led to the formulation of a ‘snapshot’ test, where the entity prior to transfer (assessed in terms of all of its various components) is compared to the business after the transfer.²³¹ Under this test, a business is transferred as a going concern where (after transfer) it ‘remains the same but in different hands’.²³² This test has been applied by the LC in analysing whether a franchise business can be transferred as a going concern from one franchisee to another.²³³ The snapshot test is easily satisfied when a franchise outlet is transferred; as the very nature of franchising requires uniformity in the operation of all businesses within a franchise network- regardless of the franchisee’s identity.²³⁴ However, this cannot be said for all businesses. Furthermore, business transfers are carried out for a variety of reasons (including failure by the old employer to run it successfully); thus the new employer cannot be expected to carry out the business in an identical manner to the previous employer.²³⁵ Therefore the snapshot test should be applied in a purposive manner that includes as many different types of business transfers as possible within the scope of section 197. It has been suggested that in order to

²²⁷ Ibid para 26.

²²⁸ Ibid para 32.

²²⁹ Supra note 224 para 13.

²³⁰ The inclusion of the word undertaking should serve as evidence that the entity concerned does not have to be a commercially driven economic entity.

²³¹ C Todd et al op cit note 2 at 49.

²³² *Chemical Energy Paper Printing Wood & Allied Workers Union on behalf of Members v Hydro Colour (Pty) Ltd & Another* (2011) 32 ILJ 1677 (LC), at para 8.

²³³ *Sanders v Cell C Provider Co (Pty) Ltd & Others* (2010) 31 ILJ 2722 (LC), at 2728.

²³⁴ See Section 5.5.

²³⁵ Furthermore, section 197 makes provision for changes to the terms and conditions of employment.

purposely apply this test, judges could adopt a lower standard that requires the transferred business to remain *substantially* the same.²³⁶

6. Chapter Five- Outsourcing and section 197

Thus far, this paper has discussed the purpose, interpretation and application of section 197 in a general context. Although many of the difficulties pertinent to the application of section 197 have already been raised; it is when courts are presented with the task of applying the section to outsourcing cases that the conceptual issues reach their peak. This chapter analyses whether the application of section 197 to outsourcing cases sufficiently promotes the protection of employment security in the event of a transfer of a business as a going concern.

6.1. What is Outsourcing?

Wallis states that outsourcing is not a term of art. Instead, ‘its form is protean and the term is used to describe a range of very different transactions.’²³⁷ Wallis also comments that outsourcing is ‘in’ whenever organisations perceive that it is to their advantage to engage in it.²³⁸ There are a range of reasons which attribute to this finding.²³⁹ Outsourcing is a viable option for many businesses for reasons such as the economic benefits of reduced overhead expenses involved with the outsourced service;²⁴⁰ management reasons;²⁴¹ or for quality purposes.²⁴² For example, in the milling sector, outsourcing has been used as an alternative employment structure because wage rates were too high, and outsourcing promoted employment flexibility by allowing for

²³⁶ C Todd et al op cit note 2 at 35.

²³⁷ M Wallis op cit note 10 at 794.

²³⁸ M Wallis op cit note 163.

²³⁹ Ibid at 2.

²⁴⁰ This is especially a factor in technology or equipment- dependent services such as IT or catering.

²⁴¹ Some outsourced activities require constant management or attention. Outsourcing such activities gives a business the ability to on its focus the income- generating or core activities.

²⁴² Some businesses do not have the internal resources or expertise to carry out the specific service in a manner that would provide them with good quality or sufficient service.

labour to be supplied according to ‘peaks and troughs’ in the demand cycle.²⁴³ Therefore, the commercial rationale behind outsourcing is that the outsourced activity is provided more affordably and more efficiently by the external service provider.²⁴⁴ However, it is necessary to highlight one of the main incentives behind outsourcing, which is pertinent to the focus of this paper. Many employers choose to restructure their businesses and outsource because of the promise of reduced labour costs.²⁴⁵ An outsourcer will only be obligated to pay the outsourcee a fee to render the services outsourced, instead of paying wages to the employees who carry out the services.²⁴⁶ Therefore, the outsourcing party does not have the burden of paying fringe benefits to the outsourced employees, who become the staff of the new employer.²⁴⁷ It is also the new employer who bears the burden of administration.²⁴⁸

Outsourcing contracts may be structured in a range of ways.²⁴⁹ For example, an employer could simply seek services from a commercial supplier already in the market. Whether this would have a significant impact on either party would then depend on the size of the contract.²⁵⁰ Another form of outsourcing can be found where former employees of a business have formed their own business, and contract to provide the services to their former employer.²⁵¹ In some cases, there will be the need for assets, equipment and licenses to be transferred, while in others, nothing tangible will pass from the old employer to the new employer.²⁵² In some outsourcing contracts,

²⁴³ Thompson, ‘*Bargaining Over Business Imperatives: The Music of the Spheres After Fry’s Metals*’ (2006) 27 ILJ 704, at 712

²⁴⁴ C Bosch op cit note 45 at 842.

²⁴⁵ Collins, ‘*Employment Law*’, (2003) Clarendon Series, Oxford Union Press, Oxford, at 198.

²⁴⁶ *NEHAWU Union v University of Cape Town & Others* (2000) 21 ILJ 1618 (LC), para 30.

²⁴⁷ Olivier, ‘*Extending Labour Law and Social Security Protection: The Predicament of the Atypically Employed*’, (1998) 19 ILJ 669, at 678.

²⁴⁸ This is based on the assumption that the parties agree to the automatic transfer of employees, or the applicability of section 197 to the transfer is not contested.

²⁴⁹ M Wallis op cit note 10 at 794.

²⁵⁰ Wallis says that replacing two security guards at a small office building is not the same as taking over security at every branch of a large organisation, as an example.

²⁵¹ For example, South African Breweries (SAB) contracted out its distribution system to drivers formerly employed by the corporation. Thus the employees became independent contractors.

²⁵² *Ibid.*

the outsourcee would require access to the business premises of the old employer in order to perform the work as stipulated by the contract,²⁵³ whereas in other circumstances, the work may be done entirely from a remote location. Thus it is important to note that the legal consequences of outsourcing contracts vary widely, according to how the contract is structured to meet the needs of the outsourcing party.²⁵⁴

The structure and consequences of an outsourcing agreement become particularly important when the question of whether this amounts to a transfer of a business as a going concern by one employer to another is raised. As emphasised by the CC - the applicability of section 197 is fact-dependent.²⁵⁵ Therefore an analysis of the outsourcing agreement, its structure, and its legal effects is necessary to establish the application inquiry.

However, this inquiry is obscured by legal and commercial developments; where the basic forms of outsourcing contracts (as set out above) have been rendered 'first-generation outsourcing'.²⁵⁶ Consequently, a legal phenomenon called 'second generation contracting out' has manifested in courts and businesses alike. This genus of outsourcing takes place where there is a change in the provider of an outsourced service. This stems from the fact that it is an outsourcer's inviolable right to have prerogative over who performs the service that has been outsourced.²⁵⁷ Consequently, two sets of circumstances have generated the mass of outsourcing litigation under the business transfer jurisprudence. The first scenario is where a company that had outsourced services to an outsourcee places the opportunity to provide the service out to tender, when the initial contract comes to an end. The outsourcing contract then enters its second generation when the original outsourcee is unsuccessful in its bid to secure the contract for an additional term.²⁵⁸ The second set of facts involves an outsourcer who becomes disillusioned with the service being rendered by the outsourcee. As the outsourcer has the right and power to cancel the initial outsourcing contract; the contract with the outsourcee is terminated, and awarded to another

²⁵³ For example, see *COSAWU v Zikhethale Trade (Pty) Ltd & another* (2005) 26 ILJ 1056 (LC), at para 25.

²⁵⁴ M Wallis op cit note 10 at 794.

²⁵⁵ Supra note 3 para 30.

²⁵⁶ M Wallis op cit note 163 at 2

²⁵⁷ Op cit note 246 para 32.

²⁵⁸ Supra note 253 para 27.

outsourcer.²⁵⁹ In both cases, the new outsourcee in effect steps into the shoes of the old (unsuccessful) outsourcee, and takes over the operation of the relevant services.²⁶⁰ Therefore, another characterising feature of outsourcing contracts is that they are very rarely permanent. Furthermore, the outsourcer generally retains a degree of control over the performance of the outsourced services.²⁶¹ These factors have been interpreted by some as reasons which count against the application of outsourcing contracts to section 197.²⁶²

The question which has consequently arisen is whether there can be a section 197 transfer between the outgoing outsourcee and the incoming outsourcee. Put differently, does second generation outsourcing constitute a transfer as contemplated by section 197 of the LRA?²⁶³ The discussion below evaluates how South African courts have approached the question of the suitability of section 197 in the outsourcing context, with regard to both first and second generation contracting out.

6.2. Defining a business in the outsourcing context

The 2002 amendments to the LRA²⁶⁴ introduced a legislative guideline on what could qualify as a business for the purposes of section 197, by way of subsection 1(a). The section was worded in such a manner that allowed for a very wide range of entities to fall under the scope of the section, including a service. However, the meaning of the word ‘service’ in regard to outsourcing cases has been highly contested. The courts have as yet to set authoritative and uncontested guidelines on whether services really do amount to businesses under section 197. Although courts have attempted to set some instructive precedent on the matter, the correct interpretation of the judgments themselves are contested.

²⁵⁹ *Aviation Union of SA & others v SA Airways (Pty) Ltd & others* (2008) 29 ILJ 331 (LC), at para 26.

²⁶⁰ Grogan, ‘*Dismissal, Discrimination and Unfair Labour Practices*’ (2007) 2nd ed Juta, at 490

²⁶¹ C Bosch op cit note 49 at 30.

²⁶² See *NEHAWU v University of Cape Town & others* supra note 246.

²⁶³ Ibid.

²⁶⁴ The Labour Relations Amendment Act of 2002.

Can a service amount to a business?

The problem with establishing whether a service is business in terms of section 197 arises from the fact that the traditional tests for determining whether something is an ‘economic entity’ or ‘organised grouping of persons and assets’,²⁶⁵ are difficult to apply (or are less efficient) in typical service cases. Not only do service-based entities characteristically perform non-core business activities, but they often have no tangible assets; and may only comprise of employees and the skills they provide. At other times, service-based entities amount to nothing more than the function that they perform.²⁶⁶ Therefore, the ECJ cautioned that an entity cannot be reduced to the activity entrusted to it.²⁶⁷ Factors outside of the services performed by an entity must exist in order to ascertain whether a transferred entity retains its identity.²⁶⁸

Prior to the promulgation of the 2002 LRA amendment, the question of whether an outsourcing agreement could amount to a transfer in terms of section 197 was answered by the LAC,²⁶⁹ which set a strict test to determine what type of businesses could fall under its scope.²⁷⁰ The Court held that only an entity with assets (movable and immovable, tangible and intangible) used to generate profit, or to attain the goals of the undertaking, can be a business.²⁷¹ This was contrary to the principles set by the first section 197 case, where the LC was willing to recognise entities that had little to no assets, and that performed non-core functions as businesses in terms of the section.²⁷² The LAC leg of NEHAWU therefore planted the root for the formalistic and form-over-substance application of section 197. And so, even subsequent to the 2002 amendment, judicial preference of the narrower interpretation of ‘service’ still existed. Thus, in

²⁶⁵ Supra note 82.

²⁶⁶ Van Niekerk, ‘*Bleached Skeletons Resurrected and Vibrant Horses Corralled - SA Municipal Workers Union v Rand Airport Management Company (Pty) Ltd & Others and the Outsourcing of Services*’ (2005) 26 ILJ 661.

²⁶⁷ Supra note 187 para 15.

²⁶⁸ These factors include the entity’s workforce, its management staff, the way in which its work is organized, its operating methods or, where appropriate, the operational resources available to it.

²⁶⁹ Supra note 62

²⁷⁰ Ibid at 312,

²⁷¹ Ibid

²⁷² See *Schutte & others v Powerplus Performance (Pty) Ltd & another*, supra note 159.

SAMWU v Rand Airport Management Co,²⁷³ the LC held that the addition of the word ‘service’ did not extend the scope of section 197 to outsourcing contracts, but merely clarifies the position that a business may consist mainly, or only of the rendering of services to another.

The LC referred to an article by le Roux²⁷⁴ which stated that the fact that a business had been defined to include a service by the amendment did not necessarily entail that the outsourcing of services amounted to a transfer of a business as a going concern.²⁷⁵ Thus the Court found that the outsourcing of gardening services *in casu* could not constitute a business, as the outsourcer had merely contracted certain services out to a contractor.²⁷⁶ This reasoning was thus accepted as authority that outsourcing agreements were excluded from the scope of section 197. This is unfortunate because, despite the narrow interpretation given to the word ‘service’, the Court did concede that whether or not an outsourcing service could be a business was a question of fact.²⁷⁷ However, the Court did not embark on a factual inquiry, and relied on the narrow definition of a business as set by the LAC in *NEHAWU*.²⁷⁸ Thus the ‘non-core’ cleaning, gardening and security services under scrutiny in the case could not constitute part of a business for the purposes of section 197.²⁷⁹

However, upon appeal by SAMWU to the LAC,²⁸⁰ the Court gave effect to the interpretational principles set LC in *Schutte*,²⁸¹ and held that any doubt that an outsourcing contract could fall under section 197 was removed by the inclusion of the word ‘service’ in subsection (1)(a) from 1 August 2002.²⁸² Applying the ordinary dictionary meaning of ‘service’,²⁸³ Davis AJA found that

²⁷³ Supra note 181 para 18.

²⁷⁴ See le Roux, ‘Consequences Arising Out of the Sale or Transfer of a Business: Implication of the Labour Relations Amendment Act’ 2002 CLL 61 at 62.

²⁷⁵ Supra note 181 para 17.

²⁷⁶ Ibid at 19.

²⁷⁷ Ibid.

²⁷⁸ The LAC in *NEHAWU* held that, ‘a business is a going concern only if its assets, movable and immovable, tangible and intangible, are utilized in the production of profit.’ Supra note 62 at 312.

²⁷⁹ Supra note 181 para 31.

²⁸⁰ Supra note 214.

²⁸¹ Supra note 159.

²⁸² Supra note 214 para 9.

the gardening service *in casu* amounted to a business in terms of section 197 despite the fact that it did not have any assets, goodwill, operational resources to be transferred to the new employer.²⁸⁴ Reliance was placed on the content of the contract, whose terms and conditions created rights and obligations fit within the ordinary meaning of the word ‘service’. This judgment was a clear attempt by the LAC to foster a permissive interpretation of section 197, and allow a wide range of entities to constitute a business that is capable of being transferred as a going concern. In *Aviation Union*,²⁸⁵ the CC emphasised that although the word ‘service’ was included in section 197(1)(a), what is capable of being transferred is the business that supplies the service, and not the service itself.²⁸⁶ The Court held that were it to be otherwise, a termination of a service contract, and the subsequent appointment of another service would constitute a transfer within the contemplation of the section; which was not the purpose of the section. This dictum could be interpreted as an attempt by the CC to provide some constraints to the potentially over-broad application of section 197 subsequent to the decision by the LAC in *Rand Airport Management*,²⁸⁷ although this was not said explicitly.

Finally, pronouncing on the art of distinguishing between a mere service and a business, the majority judgment in *Aviation Union* stated that if the old employee or outsourcing institution did not offer the service from the outset, the service cannot be said to be a business or part thereof.²⁸⁸ This dictum potentially creates excludes all outsourcing ventures where the service was not carried out by the outsourcing business before. This would particularly affect parties involved in a second generation outsourcing contract, where the initial outsourcing contract was not a service that was offered by the outsourcer. It is submitted, with respect, that this part of the judgment is rather disconcerting in light of the endorsement by the CC of a purposive approach,

²⁸³ Davis AJA applied the New Shorter Oxford English Dictionary meaning of service, which defined a service as including *inter alia*, the provision of a facility to meet the needs or for the use of a person or a person's interest or advantage; assistance or benefit provided to someone by a person or thing; an act of helping or benefiting another; the action of serving, helping or benefiting another.

²⁸⁴ Supra note 181 para 19.

²⁸⁵ Supra note 3.

²⁸⁶ Ibid para 52.

²⁸⁷ Supra note 214.

²⁸⁸ Supra note 3 para 106.

where the substance of each case is analysed on the basis of the factual matrix of each case. Thus, soon after *Aviation Union* was decided the LAC sought to clarify the meaning behind this part of the CC judgment in *Harsco Metals*.²⁸⁹ The Court held that:

‘What Yacoob J does not say, and could never be interpreted to say, is that unless there was a s 197 transfer from an outsourcing party to the first contractor there could never be a subsequent transfer from the first contractor to any second or subsequent contractor, regardless of the facts and the nature of the transaction.’²⁹⁰

The Court added that a general exclusion of that nature would be flawed, and the correct approach is for a court to scrutinise the transaction in question, and the factual circumstances surrounding it to determine whether the application of section 197 is triggered.²⁹¹ It is submitted that although a decision in the LAC cannot, by the procedural rules of South African courts, overrule a CC judgment, the approach taken by the LAC in *Harsco Metals* is in conformity with the principles of the purposive interpretation of section 197. A blanket exclusion of service-based entities would not only leave employees working for such businesses vulnerable to employment loss whenever the outsourcing is contemplated- but the employers themselves will be deprived of the smooth transfer process guaranteed by section 197.

The LAC also endeavoured to give content to how one could determine whether a service amounts to a business in terms of section 197, and underscored that the ‘economic entity’ test as set out by the ECJ in *Spijkers*²⁹² may be ineffective when applied to a business that only comprises the provision of services.²⁹³ The LAC thus referred to the ECJ judgment in *Suzen v Zehnacker Gebaudereinigung GmbH Krankenhausservice*,²⁹⁴ which would be more instructive in cases involving entities that are characterised by the activities they carry out, more than the

²⁸⁹ Supra note 82.

²⁹⁰ Ibid para 20.

²⁹¹ Ibid.

²⁹² Supra note 224

²⁹³ Ibid para 26

²⁹⁴ Supra note 187.

assets they have.²⁹⁵ The LAC held that although the ECJ judgments were useful, the Court was nevertheless bound by the *Rand Airport Management* judgment.²⁹⁶ Therefore, Van Niekerk J held that if the transfer of a group of relatively unskilled workers and the work they perform, with no assets involved were found to be sufficient to constitute a business by Davis AJA in *Rand Airport Management*, ‘then it is difficult to conceive, in the context of an outsourcing transaction, of an economic entity that would not be capable of transfer in terms of the section.’²⁹⁷ Based on this ground, the inquiry of whether a service amounts to a business came to an end.

However, it should be noted that outside of the strictures of the rules of precedent, Van Niekerk J has openly criticised the approach taken by the LAC in *Rand Airport Management*, which he has described as being ‘overly generous’. In his article,²⁹⁸ Van Niekerk raises concerns with the fact that the LAC judgment could be interpreted to mean that any service, or provision thereof, constitutes a business capable of being transferred as a going concern without any further enquiry.²⁹⁹ He argues that although a service can be a business for the purposes of section 197, in some circumstances, the whole or part of a business that carries out a service might not meet the threshold requirements that ought to define a business.³⁰⁰ Davis AJA did not follow any of the tests that had been set by the labour courts, the CC, or foreign courts such as the ECJ.³⁰¹ Instead, the applicability of section 197 to the gardening services was based on whether the contract qualified as a ‘service’ in the ordinary meaning. In response to this, Van Niekerk argues that it is

²⁹⁵ In *Suzen*, the ECJ held that components including the range of assets, goodwill, a workforce, premises, the activity performed and operating methods can be taken into account.

²⁹⁶ *Supra* note 82 para 27.

²⁹⁷ *Ibid*.

²⁹⁸ A Van Niekerk *op cit* note 266.

²⁹⁹ *Ibid* at 664.

³⁰⁰ *Emphasis added*. The threshold requirements for what would sufficiently constitute a business with regards to a service have not been set yet.

³⁰¹ i.e. whether the entity transferred that was an economic entity which was still in existence, with the same economic or similar activities after transfer. Or in the very least, an analysis of whether the entity remained the same, although in different hands after transfer, with regard to the nature of the entity (as set out by the CC in *Harsco*).

not sufficient to consider that because the nature of the operation concerned fits comfortably into the dictionary definition of a service, a business exists for the purposes of section 197.³⁰²

Although the LAC decision in *Rand Airport Management* was not *per se* incorrect, there was a lack of a substantive analysis of the facts before the Court. As mentioned above,³⁰³ when faced with outsourcing cases, there is a trend where courts gloss over the ‘business’ inquiry and focus more on the going concern question. Had the LAC launched into an appropriate query on whether there was a business, it would have been apparent that the service-related component in neither the gardening nor security services was determinative.³⁰⁴ Instead, a full investigation by the Court as to whether any components of a business existed would have been more appropriate. These components can fall within the range of assets, goodwill, a workforce, premises, the activity performed and operating methods.³⁰⁵ It is submitted that these guidelines provide for a comprehensive fact-based inquiry, which investigates whether a service amounts to a business in the outsourcing context. The examples of business components provided set the foundation for a wide range of services to fall within section 197, as the criteria are not limited to commercial or tangible assets alone. Therefore, the approach advocated by Van Niekerk allows for a balance between giving effect to the purpose of section 197 in relation to employee interests, and interpreting and applying section 197 in a manner that is justified by sound reason and consideration of the need to maintain a balance between employee and employer interests. However, the courts are yet to follow this line of reasoning and flesh out the principles surrounding the application of section 197 to services adequately. Therefore, the true meaning of the word ‘service’ has been left in the arena of academic debate, until it is finally resolved.

The disjointed precedent regarding the implications of the inclusion of services to section 197 has thus led to the demarcation between those who believe that services contracts fall within the scope of the section, and those who seem to oppose it. One of the more authoritative figures falling within the latter group is Wallis, who has expressed dissatisfaction with the interpretation

³⁰² Ibid.

³⁰³ See footnote 173.

³⁰⁴ A Van Niekerk op cit note 266 at 664.

³⁰⁵ This list was originally formulated by the ECJ in *Suzen v Zehnacker Gebäudereinigung GmbH Krankenhausservice* supra note 187 at para 15.

of service-based business cases under business transfer jurisprudence. Wallis states that the inclusion of the word ‘service’ does not extend the scope of section 197 from its prior position in the 1995 LRA. Instead, he accredits the inclusion as a means to avoid the contention that a university or similar (non-commercial) institution is not a business.³⁰⁶ Wallis reasons that, ‘one cannot extrapolate from the inclusion of a service in the definition of business an intention to bring within the operative portion of s 197 a contract for the provision of services.’³⁰⁷ However, he subsequently distinguishes between a ‘contract for the provision of services’ and outsourcing contracts;³⁰⁸ as he states that in cases involving the latter, it is never in question that at least one (and usually both) of the parties are a business in terms of section 197. However, Wallis does not set out what factors point towards an outsourcing contract, as opposed to a mere service contract. It is submitted that Wallis’ argument could be interpreted as to mean that section 197 should not apply to situations involving the contracting out of services that have no distinguishing features to establish an (economic) entity, outside of the activities carried out.³⁰⁹ If this is the case, then it is up to the courts to set out the threshold for when a set of facts or circumstances surrounding a service would amount to a business.

Regarding the development of this particular debate, it is submitted that the dual purpose of section 197 must be borne in mind at all times when attempting to apply its provisions. Although the primary purpose of section 197 has been established as the protection of employees affected by a potential business transfer by guaranteeing employment security, it is necessary to decide whether there is a business to begin with. Not every service or the contracting-out thereof should fall under the scope of section 197. Thus, courts should take note of the warning by the LC in *Schatz v Elliott International (Pty) Ltd & another*³¹⁰ that it does not automatically follow that, ‘any transaction conveniently described as ‘outsourcing’ immediately and automatically triggers

³⁰⁶ M Wallis op cit note 16 at 9.

³⁰⁷ Ibid.

³⁰⁸ In both first and second generation outsourcing.

³⁰⁹ This is in line with the reasoning of the CC in *Aviation Union*, supra note 65, and the ECJ in *Suzen v Zehnacker Gebaudereinigung GmbH Krankenhausservice*, supra note 187 and endorsed by the LAC in *Harsco Metals* supra note 82

³¹⁰ Supra note 16.

the application of section 197.³¹¹ Employers should not be encumbered with the onerous effects of section 197 every time a service within a business is contracted out to a second party, because there is no need to facilitate a business transfer where there is no such business. Hence, the elevation of the inclusion of the word ‘service’ to a determinative factor, as opposed to its illustrative role by the LAC effectively (although inadvertently) resulted in a form-over-substance approach.³¹² Judicial clarification on how to apply section 197 to services by the courts is necessary in order to end the confusion surrounding the clause. The courts need to develop a threshold test that goes beyond the going concern inquiry.³¹³ It is also submitted that the labour courts and tribunals should endeavour to set a coherent precedent in order to avoid the resort to expensive and time-consuming litigation in the High Courts, SCA or CC.

6.3. Distinguishing between bleached skeletons and vibrant horses:³¹⁴ How to apply the ‘going concern’ inquiry in the outsourcing context

In what has been labelled a ‘quaint but memorable description’,³¹⁵ the LAC held that likening the transfer of a going concern to a transaction without any accompanying transfer of employees was tantamount to ‘equating a bleached skeleton with a vibrant horse.’³¹⁶ Subsequent to this finding, the debate of when the contracting out of a service would go beyond the ‘bleached skeleton’ form, and meet the threshold requirements to qualify as a transfer of a going concern persisted. Thus, the amount paid to the definitional clause in section 197(1)(b) by courts in outsourcing cases is unsurprising. The various tests that have been formulated by courts in order to conclude that there has been a transfer of a business as a going concern have been set out above.³¹⁷ However, whether they serve any purpose in the outsourcing context is debatable. The discussion below will attempt to extrapolate some guiding principles that have been used by courts to supplement the going concern inquiry in outsourcing cases.

³¹¹ Ibid para 43.

³¹² A Van Niekerk op cit note 266 at 664.

³¹³ A Van Niekerk op cit note 266 at 665.

³¹⁴ Supra note 62 para 11

³¹⁵ A Van Niekerk op cit note 266 at 661.

³¹⁶ Supra note 62 para 11.

³¹⁷ See section 5.2.2

In an attempt by courts to ascertain when and how a transfer of a service constitutes a going concern in the outsourcing context, a lengthy history of litigation ensued after the LAC's finding in *NEHAWU*. As discussed above, the Court held that employees are a vital component in every business, and in labour-intensive industries, the major asset. Thus, a transfer of a business without the simultaneous transfer of most or all of the employees cannot be said to be a going concern.³¹⁸ It is respectfully submitted that reducing the essence of a going concern transfer to the fact that a workforce was simultaneously transferred with the entity is not only restrictive, but counterintuitive. This ignores the heterogeneous nature of individual businesses or undertakings, especially in service-based entities. The minority judgment *per Zondo* illustrates this by stating that there will be cases where the transferor and transferee agree that the workforce will be taken over by the transferee, but the transaction itself cannot be described as a going concern transfer.³¹⁹ Conversely, a transfer devoid of such an agreement, or where the parties agree not to transfer the employees, may still qualify as a transfer as a going concern because of the presence of the other factors surrounding the transfer. This dictum therefore moves away from the definitive and rigid application of section 197, which had the effect of excluding outsourcing contracts from the ambit of its protection. The objective determination of whether a transfer is a going concern therefore requires an examination of whether the type of agreement, if implemented, would attract the application of section 197 based on the factors before the Court.³²⁰ And so, whether or not a workforce is transferred should not be a decisive factor.

The CC has cautioned against the reliance that courts seem to place on the existence of an agreement to transfer employees subsequent to a business transfer- even if it is considered amongst a range of other factors. In *Aviation Union*,³²¹ Yacoob J held that one of the reasons why section 197 provides for the automatic transfer of employees was to provide for situations where the business was transferred as a going concern, but the employees were not.³²² Hence, if all the employees involved in a transferred business were transferred to the new employer, the section 197 inquiry would become irrelevant. Yacoob J therefore concluded that section 197 only

³¹⁸ Supra note 62 para 11.

³¹⁹ Supra note 62 para 65.

³²⁰ Supra note 214 para 33.

³²¹ Supra note 65

³²² Ibid para 112.

has application where, on a proper construction of a transaction, the business is transferred as a going concern without the concomitant transfer of employees.³²³ Although it is submitted that this dictum should not be interpreted as creating a hard and fast rule regarding the applicability of section 197,³²⁴ it does reduce the degree of relevance placed on whether employees have been transferred in such an inquiry. This finding also alleviates the plight of employees of an old employer in cases where outsourcing or transfer contracts explicitly assert that the employees will not be transferred to the new employer. Instead of being viewed as a factor counting against the applicability of section 197, the inclusion of ‘anti-transfer clauses’ in agreements expressly providing for the transfer of a business as a going concern will be construed as a contravention of the provision.

The minority judgment in *Aviation Union* held that the express declaration by parties that an outsourcing contract would amount to a transfer as a going concern would constitute ‘sufficient proof of the fact’.³²⁵ The minority added, however, that silence on the matter would not disprove the existence of a transfer as a going concern. It is submitted that this dictum should be read with the understanding that it has been accepted in South African courts that the intention of the transferor and the transferee should play a minor role in determining the relevance of section 197 to the transaction.³²⁶ Consequently, it is questionable whether the description of a transaction as a ‘transfer as a going concern’ by the parties involved should be construed as ‘sufficient proof of the fact’. This paper suggests that courts avoid reliance on the alleged form of the transaction, and maintain a substance-based factual analysis.

³²³ Ibid.

³²⁴ Yacoob J added that the purpose of this part of his judgment was not to supplant the test set by the CC in *NEHAWU* supra note 3. The *NEHAWU* test stated that factors relevant to whether a transfer of a business as a going concern has occurred include 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.

³²⁵ Supra note 3 para 49.

³²⁶ See *SAMWU others v Rand Airport Management Co (Pty) Ltd & others*, supra, note 214 at para 32; *Franmann Services (Pty) Ltd v Simba (Pty) Ltd & another*, supra, at para 8; *Chemical Energy Paper Printing Wood & Allied Workers Union on behalf of Members v Hydro Colour (Pty) Ltd & another*, supra note 232 at 685.

Wallis opined that courts are not immune to the tendency to try to devise rules which will answer whether there has been a transfer of a business as a going concern.³²⁷ The question that arises, however, is how and when these tests should be applied. The *NEHAWU* test seems to be the cornerstone principle in the going concern inquiry, as it has been cited in almost every subsequent business transfer case. However, its shortcomings have been raised, with ensuing judgments amending it to fit within the outsourcing framework. Authors have also suggested different ways of ascertaining whether section 197 applies to a transfer of a business by means of contracting out.³²⁸ Nonetheless, it is submitted that there needs to be a shift from the test-based paradigm, to a more flexible and fact-based mindset by the courts. Although judges set these tests as a guide to determine whether or not there has been a transfer as a going concern, the rigid application of these tests has resulted in the state of flux that the meaning of section 197 is currently in. Therefore, the inquiry of whether or not an outsourcing contract (in the first or other generation) amounts to a transfer of a business as a going concern should always be determined with reference to the circumstances before the court. It is thus reiterated that judicial tests should be applied in a manner that serves as a guideline and not a checklist that determines whether a particular transfer qualifies under section 197 or not.

6.4. Second generation outsourcing

Second generation outsourcing occurs when an initial outsourcing contract terminates for whatever reason,³²⁹ and the outsourcing party awards a new service contract to a third party. The pertinent question arising from such a scenario is whether section 197 is applicable when the business is transferred to the new outsourcee. The inherently-complicated application inquiry is further complicated by technical obstacles such as determining the roles, rights and obligations of each of the three employers, should section 197 apply to the transfer.

³²⁷ M Wallis op cit note 163 at 5.

³²⁸ In C Todd et al, op cit note 2, reference is made to a 'snapshot test', a 'dominant impression test', for example.

³²⁹ See Introduction.

6.4.1. Consequences of a tri-partite employment relationship on the applicability of section 197

Transfer by whom? Who is the old employer in second generation outsourcing?

Section 197(1)(b) requires for a business transfer to be carried out by one employer (old employer) to another employer (new employer) in order for the section to apply. Although this requirement is easily met in ordinary business transfers or first-time outsourcing ventures, the meaning of the word ‘by’ is highly contested when the section is applied to a second generation outsourcing contract, where there are more than two employers involved. The question thus becomes whether section 197(1)(b) requires a positive act to be carried out by the old employer.³³⁰ This inquiry is additionally complicated by the question of who is the old employer when a new outsourcee is awarded a service contract that was once carried out by an old outsourcee. Furthermore, does the absence of a contractual nexus between the two contractors exclude second generation transfers from section 197? The discussion below attempts to determine whether the tri-partite nature of second generation transfers affects the applicability of section 197 to such cases.

The first case that dealt with the application of section 197 to second generation contracting out was the LC judgment of *COSAWU v Zikhethale Trade (Pty) Ltd & another*.³³¹ Although not significantly raised by the parties *in casu*, the Court stated that a strong argument could be made that section 197 does not apply to cases involving second generation contracting because the express language of subsection (1)(b) requires that a transfer be *by* one employer to another.³³² Thus under this line of reasoning, in a second generation contract- where there is no actual business transfer from the outsourcer to the new outsourcee, section 197 cannot apply. However, Murphy AJ held that placing emphasis on the word ‘by’ would amount to a literal interpretation of the clause, which would lead to the ‘anomaly’ that workers transferred as part of first

³³⁰ M Wallis op cit note 163, at 9.

³³¹ Supra note 253.

³³² Ibid para 28.

generation contracting out would be protected, whereas those in second generation transactions would not.³³³ This would infringe the right to equality that is afforded to everyone by section 9 of the Constitution.³³⁴

The judge also stated that a literal interpretation of the word ‘by’ could provide a mechanism for unscrupulous employers to circumvent the effects of the business transfers clause by creating a legal loophole in the case of second generation transfers.³³⁵ Therefore, in accordance with Todd et al,³³⁶ Murphy J reasoned that section 197(1)(b) might be better interpreted if the word ‘from’ was used in place of the word ‘by’,³³⁷ in order to avoid the interpretational challenge.³³⁸ This interpretation was drawn from European jurisprudence,³³⁹ and entails a two-phase transfer in cases involving second generation contracts. In the first phase, the contract is handed back to the initial old employer (the outsourcer) by the outgoing contractor; and in the second phase, the old contractor hands the contract to the new successful outsourcee.³⁴⁰ Murphy AJ endorsed this interpretation, as a pragmatic means to give effect to the interpretational mandate set by section 39(2) of the Constitution.³⁴¹ Thus the judge held that substituting the word ‘by’ with the word ‘from’ would ensure equal protection of all employees faced with a transfer of a business.³⁴² Finally, Murphy J held that the absence of a contractual link between the old and new employer should not be a decisive criterion in the determination of whether a transfer falls under section 197 or not.³⁴³ Instead, more focus should be paid to whether the undertaking has retained its

³³³ Employees in second generation transfers would have no guarantee of employment continuity or the right to severance benefits.

³³⁴ See Chapter Six.

³³⁵ Supra note 253 para 29.

³³⁶ C Todd et al op cit note 2 at 27.

³³⁷ Thus, section 197(1)(b) would read ‘“transfer” means the transfer of a business from one employer (the old employer) to another employer (the new employer) as a going concern.’

³³⁸ Supra note 253 para 29.

³³⁹ See *Dines & others v Initial Health Care Services Ltd & another* [1994] IRLR 336 (CA).

³⁴⁰ C Todd et al op cit note 2 at 27

³⁴¹ This clause instructs that, ‘(w)hen interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.’

³⁴² Supra note 253 para 29

³⁴³ Ibid para 34.

identity subsequent to transfer, and if the transferred entity is the same business, but in different hands.³⁴⁴

Soon after the *Cosawu* decision, Wallis raised a few concerns with the interpretation adopted by the Court.³⁴⁵ Firstly, Wallis states that the definition of a transfer in section 197(1)(b) only contemplates two positive actors in the process (the old and the new employer)- and no one else. The two-stage approach endorsed by the LC is criticised, as the author comments that there is no suggestion in the wording of the clause of ‘a transfer by inadvertence or of compulsory but helpless compliance by the old employer.’³⁴⁶ Therefore, the author states that the section does not apply when a contract for the provision of services between an outsourcing business and an outsourcee comes to an end and is awarded to a third party. This is because the use of the word ‘by’ in the section entails that the old employer is a positive actor in the process.³⁴⁷ However, in practice, the outgoing outsourcee would not be a positive actor in the transfer to the new employer, and is unlikely to ‘extend a hand of congratulations to the winner and promise it every support.’³⁴⁸ Although this paper does not challenge the correctness of Wallis’ argument, it is submitted that the emphasis placed on the role of the ‘positive actor’ could imply an additional requirement in section 197(1)(b) that the transfer be a voluntary act by the old employer. Whether or not an unsuccessful outsourcee decides to consult its attorney to challenge the tender process (as Wallis suggests is a likely reaction) should not affect the applicability of section 197 to the transfer to the new outsourcee.

Wallis states that replacing ‘by’ with ‘from’ eliminates the positive role that the old employer plays in the transfer process, and reduces it to a passive position, where the unsuccessful outsourcee cannot fight ‘strenuously to resist it’.³⁴⁹ Once again, it is submitted that an outsourcee’s willingness (or lack thereof) for there to be a transfer to the new outsourcee should not be construed as a catalyst for the application of section 197. It is established that once the

³⁴⁴ Ibid para 35.

³⁴⁵ M Wallis op cit note 163.

³⁴⁶ M Wallis op cit note 163 at 10.

³⁴⁷ M Wallis op cit note 163at 12.

³⁴⁸ Ibid.

³⁴⁹ Ibid.

conditions of section 197 are met, the consequences follow regardless of the intentions of the parties involved.³⁵⁰ Thus an outsourcee's displeasure at losing an outsourcing contract should play no role in determining whether awarding a new contract to the new outsourcee amounts to a transfer of a business as a going concern.

Another argument against the application of section 197 to second generation contracts is the fact that the Legislature chose to keep the word 'by' in section 197(1)(b), even after the 2002 Amendment Act, which sought to clarify some of the issues surrounding the interpretation of the section.³⁵¹ Wallis states that the reason behind this was to maintain the balance in the protection of both employee and employer interests.³⁵² This raises the issue of the dual purpose of section 197, as set out by the CC.³⁵³ And so, Wallis asserts that the Legislature deliberately kept the word 'by' to limit the scope of the section to transactions where two parties decide to transfer a business as a going concern.³⁵⁴ In *Aviation Union*, the SCA judgment raised similar points, and found that a second generation transfer from A to C, or even from B to C, is not a transfer for the purposes of section 197.³⁵⁵ The Court held that interpreting 'by' in section 197(1)(b) as 'from' would disregard the words used by the Legislature, which would lead to uncertainty and a failure by courts to respect the doctrine of separation of powers.³⁵⁶ Thus, the deliberate use of the word 'by' and the 'plain and unambiguous' language of section 197 indicates that there should be two positive actors in the transfer process, in order to give effect to the ordinary meaning of the section.³⁵⁷ The Court accordingly found that to read 'from' into section 197 would change the meaning of the section as a whole, and is contrary to the Legislature's intention.³⁵⁸

Although the rules of statutory interpretation do call for the ordinary meaning of a statute to be given effect to as far as is possible, this rule must be applied subject to the mandate set by section

³⁵⁰ Supra note 66 at para 7.

³⁵¹ The Labour Relations Amendment Bill of 2012 also made no changes to the use of the word 'by'.

³⁵² M Wallis op cit note 163 at 13.

³⁵³ Supra note 3 at 35.

³⁵⁴ M Wallis op cit note 163 at 13.

³⁵⁵ *South African Airways (Pty) Ltd v Aviation Union of South Africa & others* (2011) 2 BLLR 112 (SCA)

³⁵⁶ Ibid para 19.

³⁵⁷ Ibid para 30.

³⁵⁸ Ibid para 33.

39(2) of the Constitution.³⁵⁹ Thus a purposive interpretation of section 197 that sufficiently protects the constitutional right to fair labour practices should be preferred. The CC accordingly disagreed with the SCA when the matter was taken on appeal.³⁶⁰ The Court criticised the reliance on a single word to interpret an entire clause, stating that ‘undue emphasis’ was given to the meaning of ‘by’, with little regard to the context or purpose in which the section appears, or the purpose of the LRA as a whole.³⁶¹ The CC identified the judicial focus on who was the transfer was carried out by, rather than what was being transferred, as a factor that obscured the inquiry of the applicability of section 197 to second generation outsourcing.³⁶²

An important principle set by the majority regarding the role of each of the three employers in a second generation transfer, is that the concept of an ‘old employer’ and ‘new employer’ is not static. In this regard, it is necessary to set out how this principle would be applied in practice:

‘In transfer one by A to B, A is the old employer, and B the new employer; in transfer two by B to C, B is no longer the new employer but the old one, and C becomes the new employer; and if transfer two is by B back to A, B will be the old employer and A, who had been the old employer in the first transfer, becomes the new employer in the second transfer.’³⁶³

Thus the CC endorsed the two-phase approach set out by Todd et al, and the LC in *COSAWU*.³⁶⁴ The fact that the old outsourcee *in casu* (LGM) would carry out the transfer by way of ‘compulsory but helpless compliance’³⁶⁵ did not affect the inquiry. Furthermore, the lack of a contractual nexus between A and C had no effect on whether section 197 applies to second generation contracts. Yacoob J chose to interpret section 197(1)(b) in a manner that would give effect to its intended purpose, without resorting to a substitution of the word ‘by’ with ‘from’, as he held that ‘by’ must be given its ordinary meaning.³⁶⁶ Although it is difficult to declare that

³⁵⁹ See section 4.1.

³⁶⁰ Supra note 65.

³⁶¹ Ibid para 54.

³⁶² Ibid para 102

³⁶³ Ibid para 103.

³⁶⁴ See footnote 339

³⁶⁵ See footnote 346.

³⁶⁶ Supra note 65 para 113.

this judgment put the debate surrounding the wording of subsection (1)(b) to an end, the CC judgment can be accepted as the most authoritative guideline regarding the matter. However, Wallis commented that the facts surrounding *Aviation Union* were ‘substantially different’ from the typical second generation outsourcing cases, ‘where services, such as cleaning, gardening or security, involving no transfer of assets, had been outsourced.’³⁶⁷ Thus there is a possibility that future courts could distinguish *Aviation Union* based on the fact that there was a transfer of assets and premises to the new employer by the outgoing contractor- LGM,³⁶⁸ which the latter was obliged to do by terms of the initial outsourcing contract with the outsourcer.³⁶⁹ This means that the ordinary meaning of the word ‘by’ could easily be applied in such a situation, where LGM was a positive actor in the transfer process (albeit, in terms of a contractual obligation) although the same cannot be said of second generation outsourcing cases such as those described by Wallis. This leads to the question of whether section 197 adequately serves its purpose in its current form, as will be discussed in Chapter 6.

The discussion below, however, raises some general remarks made by the CC, regarding the legal distinction between first and second generation transfers.

6.4.2. Does the distinction between first and second generation outsourcing serve any purpose?

The distinction between first and second generation business transfers has played an important role in litigation surrounding section 197. This section examines how the courts have treated this theoretical distinction and applied it in practice. Furthermore, the question of whether the distinction serves any purpose will be addressed.

³⁶⁷ M Wallis op cit note 10 at 788.

³⁶⁸ The majority found that upon cancellation of the outsourcing contract between South African Airways and LGM, the latter would have to transfer the computers, airport space, leased property, fixed assets and inventory to the new contractor. See para 121.

³⁶⁹ Although whether there was an obligation on LGM to carry out the transfer was debated, the majority found that the cancellation clause of the contract contemplated a transfer of the business as a going concern. See para 124.

An important principle that emerged from the CC judgment in *Aviation Union* is that the question of the applicability of section 197 would be ‘misleading if it focuse(d) solely or mainly on the ‘generation’ of the transfer.’³⁷⁰ The Court furthermore stated that, ‘(i)t does not matter in principle what the ‘generation’ of the outsourcing is, or even whether the transaction is concerned with contracting out at all.’³⁷¹ The true inquiry is whether there is a transfer of a business as a going concern by the old employer to the new employer, which the Court warned is a complex enough question to answer without the inclusion of generations of transfers. Furthermore, Yacoob J commented that what might be deemed a ‘first generation’ transfer might not fall under section 197, whereas ‘a ‘fifth generation’ outsourcing could be caught by the section if it is in reality the transfer of a business as a going concern.’³⁷²

This finding is consonant with Wallis’ description of second generation contracting out as ‘catchy but inaccurate’, phrase that describes nothing more than a decision by a party to change its supplier.³⁷³ Wallis warned against the form-based application of section 197 and argued that, ‘(m)erely because there may have been some prior outsourcing decision by the principal does not make the change of contractor into an outsourcing of any generation.’³⁷⁴ The form of the transaction should never substitute the use of a comprehensive factual analysis of whether what is being outsourced is a business as a going concern. Importantly, Yacoob J stated in *Aviation Union* that, ‘it is quite impossible to determine in the air that a second generation outsourcing agreement does or does not amount to a transfer of a business as a going concern.’³⁷⁵

The various tests used to establish a going concern transfer have been discussed above.³⁷⁶ However, the test set by the CC in *Aviation Union* was specifically formulated with second generation transfers in mind, to determine whether there is a transfer by the old employer to the new employer as a going concern. The test is set out in full below:

³⁷⁰ Supra note 65 para 105.

³⁷¹ Ibid.

³⁷² Ibid para 105.

³⁷³ M Wallis op cit note 163 at 2.

³⁷⁴ Ibid at 3.

³⁷⁵ Supra note 65 111.

³⁷⁶ See section 5.2.2.

‘Does the transaction concerned create rights and obligations that require one entity to transfer something in favour or for the benefit of another or to another?’

If so, does the obligation imposed within a transaction, fairly read, contemplate a transferor who has the obligation to effect a transfer or allow a transfer to happen, and a transferee who receives the transfer?’

If the answer to both these questions is in the affirmative, then the transaction contemplates transfer by the transferor to the transferee. Provided that this transfer is that of a business as a going concern, for purposes of s 197, the transferee is the new employer and the transferor the old. The transaction attracts the section and the workers will enjoy its protection.³⁷⁷

It is restated that one must not place too much reliance on tests set by the courts as guidelines. However, they may be helpful when applied subject to the unique nature of each set of facts or business transaction placed before a court.

The discussion above has alluded to the judicial preference for a fact-dependent interpretation of section 197, regardless of the generation of the business transfer. Therefore, an inevitable question that arises is whether the distinction between first and subsequent transfers is necessary at all. In the SCA leg of the *Aviation Union* case, the Court held that what has been termed a second generation outsourcing is ‘nothing of the sort.’³⁷⁸ The Court held that this is because when an outsourcing contract between an outsourcer and an outsourcee is terminated, the subsequent transfer by the outsourcer to a new outsourcee is no more than a new first generation transfer.³⁷⁹ Although the CC overruled the SCA judgment, this issue was not raised by the Court.

The importance of the distinction between first and second generation outsourcing has not been discussed sufficiently in South African courts, as the main focus surrounds the effects of a transfer falling under either one. Although Wallis does not remark on the efficacy of the distinction, he comments that the conceptual difference between first and second generation outsourcing makes a difference in practice, ‘in the same way that it is helpful conceptually to know whether one is dealing with an apple or a pear.’³⁸⁰ In amplification, he comments that

³⁷⁷ Supra note 65 at 113.

³⁷⁸ Supra note 355 para 4.

³⁷⁹ Ibid.

³⁸⁰ M Wallis op cit note 163.

although the difference does not seem to have any impact, ‘not to distinguish between different factual and legal situations is a recipe for disaster.’³⁸¹ Although the correctness of this argument is not contested, it is submitted that a sufficient analysis of the factual matrix placed before a court should be an adequate means to determine when a change in the employer of a business amounts to a going concern transfer. How the labeling of a transfer according to its generation affects this inquiry is not immediately clear.

Perhaps some of the difficulties faced by judges in interpreting section 197 could be overcome if every transfer was treated as a first generation transfer, as the tendency to apply new or different requirements for second generation contracts would be done away with. This paper does not suggest that removing the notion of second generation outsourcing would have a fundamental impact on the applicability of section 197. However, removing the distinction between first and second generation outsourcing may remove the conceptual hurdle that is inherent in the latter cases, and oftentimes obscures the true issues before a court. This paper has reiterated that the pivotal elements in applying section 197 to a set of facts are the facts before a court and the nature of the business being transferred. The importance of these factors can be easily lost when the inquiry turns to the generation of the transfer. Thus it is submitted that the protection of employees’ right to job security could be carried out more robustly if such interpretational obstacles were removed from the section 197 application inquiry.

6.5. Can section 197 be applied to franchise businesses?

Franchises are unique business structures, described in the Oxford English Dictionary as, ‘an authorization granted by a government or company to an individual or group enabling them to carry out specified commercial activities, for example acting as an agent for a company’s products.’ The franchisor thus grants a franchisee the right to conduct a business within their network, selling the franchisor’s products or services, and using their name. This section analyses whether upon the termination of a franchise contract, the subsequent transfer of the business to a new franchisee amounts to a transfer as a going concern in terms of section 197.

³⁸¹ Ibid.

The section will also address whether the legal principles governing business transfers through outsourcing contracts can be applied to the transfer of franchise businesses.

There are four essential elements that characterise a franchise relationship.³⁸² First, franchisees have a right to operate the franchisor's method of business (usually including the licensing of the use of intellectual property rights and trade know-how). Secondly, there will be a distribution contract to sell certain types of products or services. Thirdly, the franchisee operates as an independent business (although this is subject to the terms of the franchise contract). Finally, there is direct or indirect financial remuneration paid to the franchisor for the right to conduct a franchise business.

Therefore, a prominent feature of franchise businesses is the uniformity in the manner that business is conducted, and the types of products and services sold in each franchise outlet. The daily function of a franchise remains the same, regardless of the franchisee who is in charge of a particular outlet.³⁸³ If a franchise contract lapses or is terminated by the franchisor for whatever reason, the new franchisee who takes over the franchise essentially steps into the shoes of the old franchisee and continues to run the business in the exact same manner.³⁸⁴ At the end of a franchise contract, a franchisee will usually vacate the business premises and leave the furniture and fittings on the premises behind.³⁸⁵ Many franchise contracts also make provision for 'handover plans', whereby the old franchisee assists the new franchisee in acquiring the business. Furthermore, customers of the business are the customers of the franchise, and not the individual franchisee, as they are attracted to the name and reputation of the franchise- and not the identity of the employer.³⁸⁶ Therefore, the customers of a franchise will continue making use of the business, regardless of the change in the particular franchisee that runs the outlet.

³⁸² *PE Pack 4100 CC v Sanders & others* (2013) 34 ILJ 1477 (LAC), at para 15.

³⁸³ *Ibid* para 10.

³⁸⁴ Davis JA commented in *PE Pack*, *ibid* that 'the only visible difference (*in casu*) would ostensibly have been that there were some new faces behind the counter.' At para 10.

³⁸⁵ The franchisee in *PE Pack*, left behind 'the entire infrastructure', including the premises, furniture, and operating systems.

³⁸⁶ See *Silent Pond Investments CC v Woolworths (Pty) Ltd and another* 2011 (6) SA 343 (D), at para 20.

The question that inevitably arises from this analysis is whether upon the termination of a franchise contract, the transaction subsequent to the creation of a new franchise contract amounts to a transfer in terms of section 197. Put in another way, does the outgoing franchisee transfer the business to either the franchisor or the incoming franchisee as a going concern? This question was brought before the LC, where the Court held that section 197 applies when a new franchisee takes over a business after the franchisor terminated a prior contract with the outgoing franchisee.³⁸⁷ Applying the same reasoning as the LC in *FAWU v Cold Chain (Pty) Ltd & another*,³⁸⁸ De Swart JA used the ‘snapshot test’, where a snapshot of the entity’s components before the transfer is compared to the picture of the business after transfer.³⁸⁹ The Court found *in casu* that the business- a franchise outlet of the Cell C Provider Company, remained essentially the same after the transfer to the new franchisee from the old franchisee.³⁹⁰ The snapshot test revealed a ‘similar picture’ before and after transfer, as ‘the businesses remained located in exactly the same place, the telephone numbers remained the same, and the nature of the business remained the same.’³⁹¹

The Court also restated the importance of a purposive interpretation of section 197, and that the purposes of section 197 are not achieved by an interpretation, ‘that entails job losses or the termination of the continuation of the employment of the employees who moved with the work.’³⁹² Thus the Court found that the exclusion of franchises from the scope of section 197 would narrowly construe the provisions of the section and defeat its purpose in safeguarding employment.³⁹³ The matter was then taken on appeal to the LAC.³⁹⁴ Instead of applying the ‘snapshot test’ to the case, Davis JA quoted the two-step test set by Yacoob J in *Aviation Union*.

³⁸⁷ *Supra* note 233.

³⁸⁸ (2009) 30 ILJ 2919 (LC).

³⁸⁹ *Supra* note 233 at 2727.

³⁹⁰ The Court found that there was an outlet, selling cell phone contracts, airtime, providing for phone repairs or enquiries before and after the transfer.

³⁹¹ *Supra* note 233 at 2728.

³⁹² *Ibid*.

³⁹³ *Ibid* 2729.

³⁹⁴ *Supra* note 382

Davis JA reasoned that in order to answer the question of whether franchise agreements satisfy the *Aviation Union* test, the nature and essential elements of franchise businesses would have to be analysed first.³⁹⁵ As illustrated above, the process that follows the termination of a franchise contract could easily be identified as a transfer of a business as a going concern. However, Davis JA stated that it is important to note that franchisees act in accordance to their franchise agreements.³⁹⁶ A franchisee has to follow detailed instructions laid down in the franchise agreement, and operates as ‘a servant or employee’ of the franchisor in regard to the conduct of the business.³⁹⁷ Thus, the new franchisee’s continuation or operation of the business in essentially the same manner as the old franchisee is not an instance of a going concern transfer, but a consequence of the fact that a franchisee is bound to the terms of the franchise agreement.³⁹⁸

Davis JA warned against applying the outsourcing jurisprudence to a franchise business because of the unique nature of a franchise relationship.³⁹⁹ The judge quoted an article by Woker,⁴⁰⁰ where the author asserts that although they are independent entities, franchisees are not free to develop their businesses as they please. Franchisees ‘buy into the franchisor’s business model.’ The franchisor consequently exercises great control over the way that the franchisees operate.⁴⁰¹ Therefore, franchisors usually dictate the location of the business; advertising and selling methods; the appearance of business premises; the types of products and services offered; book-keeping methods; hours of business; appearance of staff; and product prices. This is known as ‘business-format franchising’, where there is an ongoing business relationship between the franchisor and franchisee.⁴⁰² Thus, although the transfer to a new franchisee seems to satisfy the

³⁹⁵ Ibid.

³⁹⁶ Ibid para 16.

³⁹⁷ See *Van Rensburg v Straughan* 1914 AD 317, at para 328; *Longhorn Group (Pty) Ltd v The Fedics Group (Pty) Ltd and Another* (1995) 4 All SA 194 (W), at 200.

³⁹⁸ Supra note 382 para 17.

³⁹⁹ Ibid para 21.

⁴⁰⁰ Woker, ‘*The franchise relationship and the problem of encroachment: Silent Pond Investments CC v Woolworths (Pty) Ltd*’, (2008) 20 South African Mercantile Law Journal 402.

⁴⁰¹ Ibid at 405.

⁴⁰² *Cancun Trading & Others v Seven-Eleven Corporation SA (Pty) Ltd* (2000) CPLR 173 (CT), at para 3.

requirements in section 197(1), the distinctive nature of these business structures requires ‘great care’ before principles from outsourcing jurisprudence can be applied.⁴⁰³

The Court found *in casu*, that the new franchisee had not acquired the business as a going concern from the old franchisee, because the termination of the franchise contract by the franchisor was actually a termination of the license to operate the business on the latter’s behalf.⁴⁰⁴ Thus, the Court found that such a contract could not be equated to an outsourcing agreement. There was no transfer of assets by the outgoing franchisee to the new franchisee that was comparable to the facts in *Aviation Union*. The new franchisee merely took over the right to conduct the business on the franchisor’s behalf.⁴⁰⁵

The question that stems from this discussion is whether South African courts will exclude all franchise businesses from the scope of section 197, or whether there is a possibility for the section’s applicability to some franchise contracts. It is necessary to mention the difficulty in answering this question, as there is no other authority in South Africa regarding the applicability of section 197 to franchises outside of the two judgments in the *PE Pack* case. It is also submitted that the majority decision by the LAC in *PE Pack* does not seem to create a blanket exclusion, as Davis JA warned that ‘great care’ must be taken before applying section 197 to franchises.⁴⁰⁶ He did not however, state that this can never be done.

The ECJ decision of *Albert Merckx and Patrick Neuhuys v Ford Motors Belgium SA*⁴⁰⁷ involved two employees (the applicants) who worked for a franchise outlet of the respondent company. Upon termination of the franchise contract with the applicants’ employer, the employees refused to be transferred to the new franchisee. They argued that they were not obliged to be transferred as there was no transfer of the business as a going concern in terms of the EEC Directive 77/187.⁴⁰⁸ Interpreting the Directive in the context of its purpose to protect employees in the

⁴⁰³ Supra note 382 para 21.

⁴⁰⁴ Supra note 382 at 18.

⁴⁰⁵ Ibid.

⁴⁰⁶ Ibid para 21.

⁴⁰⁷ (1996) IRLR 467 (ECJ).

⁴⁰⁸ Ibid para 12.

event of a change of employer, the Court held that the change in franchisees amounted to a transfer as a going concern, meaning that the employees had to be transferred to the new franchisee.⁴⁰⁹ Applying a broad interpretation of the Directive, the Court found that it would apply ‘even if (the franchise) is carried on under a different name, from different premises and with different facilities.’⁴¹⁰ A plausible argument could be raised that the interpretation of a going concern transfer by the ECJ in *Mercxk* was overly broad. However, the case serves as authority for the argument that a purposive interpretation of business transfers as a going concern allows for the application of transfer clauses to franchise agreements.

It goes without saying that a transfer of a franchise business will usually satisfy the ‘snapshot’, ‘economic entity’ and ‘same business but different hands’ tests because of the uniform nature of franchise businesses. However, one could argue that the *Aviation Union* test is also satisfied when a franchise contract obliges an outgoing franchisee to facilitate the handover of the business to an incoming franchisee.⁴¹¹ This does seem to ‘create rights and obligations that require one entity to transfer something in favour of another.’⁴¹² Consequently, a franchise agreement would also ‘contemplate a transferor who has the obligation to effect a transfer... and a transferee who received the transfer.’⁴¹³ Furthermore, one of the decisive factors in the LAC’s judgment was the fact that, unlike the contract in *Aviation Union*, the franchise agreement was not worded in a manner that expressly provided for a transfer in terms of section 197, upon the cancellation of the contract.⁴¹⁴ Although this paper submits that the form of a transaction (as stated in the contract regulating it) should not be a decisive criterion, if a franchise agreement contemplates the transfer of employees along with the other assets for the business, section 197 could find application. The Court in *PE Pack* also found that the fact that the franchisor retained ownership of the entire business infrastructure and fixed assets indicated that there was never any transfer of the business.⁴¹⁵ However, given the various forms of business arrangements, perhaps

⁴⁰⁹ Ibid para 28.

⁴¹⁰ Ibid para 21.

⁴¹¹ The contract in *PE Pack* required the outgoing franchisee to facilitate the handover to the new franchisee.

⁴¹² As required by the first part of the test.

⁴¹³ As required in the second part of the test.

⁴¹⁴ Supra note 382 para 19.

⁴¹⁵ Ibid para 21.

section 197 could apply to a franchise agreement where the franchisee owns or controls (in the form of a lease) the business infrastructure, and transfers it to a new franchisee upon the termination of the initial contract.

The final issue raised with the majority judgment in *PE Pack* is the fact that the Court placed so much emphasis on the nature of franchise contracts. There was no analysis of whether the wording of section 197 could provide for the inclusion of franchise businesses in its compass. Thus the majority judgment's inquiry adopted a form-over-substance approach. The minority judgment provided a more objective factual inquiry that looked at the substance of the transaction, as required by the CC in *NEHAWU*.⁴¹⁶ The majority raised the interpretational principles set by the CC, but did not actually apply them. Thus it is respectfully submitted that paying lip-service to interpretational guidelines and then focusing on the nature of a business to reach a conclusion might fall short on the mandate placed on courts to safeguard employment security in the event of business transfers.

The future of the relationship between franchise businesses and section 197 is difficult to predict, as it is an area of law that is in need of further development. There are indications that count on both sides of the scale, and it is open to the courts to give more authority on the issue. It is submitted however, that creating a blanket exclusion based on the form of franchise businesses might be contrary to the purposive interpretation of section 197.

7. Chapter Six- Does section 197 provide adequate protection to all employees in its current form?

Thus far, this paper has analysed the issues surrounding the interpretation and application of section 197 in the range of circumstances that possibly fall under its scope. The wording of the section is undoubtedly problematic. It is clear that there will be a wealth of litigation surrounding business transfers in the foreseeable future, as the guidelines and principles set by the courts are

⁴¹⁶ For example, the minority analysed the fact that upon termination of the contract, the old franchisee would have to vacate the premises and assist in a handover plan, the business would continue, the same customer base would continue to make use of the business, and the old franchisee had to remove all of its possessions and stock from the premises (amongst other things).

open to interpretation and debate. It is also common for loopholes within a statutory provision to manifest with the development of the area of law that the clause regulates. This discussion addresses the potential inadequacy of section 197 in its purpose to safeguard employment security that has manifested in case law and academic discussions.

The issues surrounding the application of section 197 to outsourcing cases (and more specifically, second generation transfers), were commendably engaged by the CC in *Aviation Union*.⁴¹⁷ However, Wallis raises the issue that the facts of the case were ‘substantially different’ from typical outsourcing cases in South Africa.⁴¹⁸ Thus, it is not clear whether a court faced with a case involving a service-based business that is not employee-dependent, with little to no assets, or does not require occupation of the business premises, would find that section 197 applies. In *Aviation Union*, the Court held that the requirements of section 197(1)(b) are satisfied in a second generation transfer because the outgoing outsourcee transfers the business back to the outsourcer, who then (in his capacity as the old employer) transfers it to the incoming outsourcee.⁴¹⁹ The two-phase transfer approach was an appropriate solution to the conundrum before the CC, because there were assets in the form of premises, infrastructure and machinery that needed to be transferred from one employer to the other. However, as in the typical second generation transfer cases, which mostly involve service-based entities, the transition from one outsourcee to another ‘will be relatively seamless’, because there will be nothing tangible to transfer.⁴²⁰

In many second generation transfers, outsourcers advertise tenders and award new contractors before the existing contract expires or is terminated. Thus, the transition to the new outsourcee would occur swiftly upon termination, and without resort to a two-phase transfer as suggested by the CC. Therefore, in such circumstances, the outsourcer would not be the (old) employer of the affected workers, nor would they have effected any transfer.⁴²¹ Although the outsourcer would cause the transfer to occur by terminating the initial outsourcing contract, the transfer would not

⁴¹⁷ Supra note 65.

⁴¹⁸ See page 58.

⁴¹⁹ Supra note 65 para 104.

⁴²⁰ M Wallis op cit note 10 at 797.

⁴²¹ Ibid.

have been carried out by the outsourcer as the old employer. And so, Wallis argues that the peculiar facts of *Aviation Union* do not alter the requirements of section 197(1)(b), but reinforce them, because South African Airways was the old employer after the contract with LGM was terminated, and before it was transferred to the new outsourcee.

It is also important to recall that the CC rejected the substitution of the word ‘by’ with ‘from’, and held that ‘by’ should be construed according to its ordinary meaning.⁴²² The case turned on the fact that the outsourcing contract contemplated a transfer as a going concern upon cancellation.⁴²³ Thus, to the extent that the wording of section 197(1)(b) requires the old employer to actively transfer the business, transfers of businesses that are structured differently to LGM in *Aviation Union* might be excluded from section 197. In consequence, despite the abundance of litigation surrounding the meaning of the word ‘by’, ‘(w)e are back where we started with a section that requires to be applied in the context of particular business transactions.’⁴²⁴ This resurrects a comment made in 2004 that section 197 is ‘arguably deficient’ to the extent that the old employer is required to play an active role in the transfer.⁴²⁵ Perhaps a constitutional challenge on the inadequacy of section 197(1)(b) in giving effect to the right to fair labour practices for employees involved in a second generation transfer should be raised.⁴²⁶ One could frame such a claim thus: section 197(1)(b), read in accordance with the ordinary meaning of ‘by’, is unconstitutional to the extent that it infringes the constitutional right to fair labour practices by excluding employees in second generation transfers. This is yet to occur in South African courts.

Would a constitutional challenge against section 197 succeed?

The Constitution is the supreme law in South Africa, and ‘any law or conduct inconsistent with it is invalid.’⁴²⁷ Any statutory provision which is inconsistent with the Constitution is of no force or

⁴²² Supra note 65.

⁴²³ Ibid para 124.

⁴²⁴ M Wallis op cit note 10 at 794.

⁴²⁵ C Bosch op cit note 49 at 931.

⁴²⁶ Ibid.

⁴²⁷ Section 2.

effect, to the extent that it is inconsistent.⁴²⁸ A court with constitutional jurisdiction may either invalidate or limit the unconstitutional provision.⁴²⁹ However, before any such order is made, a court has to carry out a limitations analysis in terms of section 36. This entails an inquiry of whether the statutory limitation of a right in the Bill of rights is ‘reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom...’⁴³⁰ The CC has held that this is established through the use of a two-stage test.⁴³¹ The first stage inquires whether there has been a contravention of a guaranteed right. If yes, the second stage inquires whether such a contravention is justified under the limitation clause.⁴³²

It is submitted that the section 36 analysis is difficult, if not impossible to apply to section 197. As this paper has endeavoured to illustrate, whether or not a particular business transfer falls under section 197 depends on the facts before a court. Reiterating a point made in *Aviation Union*, it cannot be determined ‘in the air’ whether a second generation transfer meets the threshold requirements in section 197(1).⁴³³ The section has been found to be applicable in some second generation outsourcing cases, where in other cases, it has not. The very nature of section 197 calls for this determination to be made on a case by case basis, regardless of the type or generation of the transfer. There is no blanket exclusion of any particular type of transfer. Therefore, it is submitted that a court’s decision that section 197 is inapplicable to a particular case, based on the specific facts thereof, is not equivalent to a limitation of the right to fair labour practices in terms of a law of general application.

An equality-based claim that section 197(1)(b) indirectly discriminates against employees in second generation outsourcing transfers by requiring a positive act by the old employer is therefore also likely to fail. One cannot claim they have been discriminated against when the facts of a case fall short of the requirements set by section 197. It seems that the only remedy for

⁴²⁸ JR de Ville op cit note 113 at 91.

⁴²⁹ In terms of section 172(1)(1) and (b) of the Constitution.

⁴³⁰ Section 36(1).

⁴³¹ *S v Zuma and Others* 1995 (2) SA 642 (CC), at para 20. See also, *S v Makwanyane and Another* 1995 (3) SA 391 (CC), at 100.

⁴³² The justification analysis is carried out with reference to the listed factors found in section 36(1)(a) to (e).

⁴³³ *Supra* note 65, at para 111.

an unsatisfied litigant in either of the two scenarios set out above would be for the court's interpretation of section 197 to be scrutinised by an appeal court.

Wallis also raises some policy arguments against raising a constitutional challenge on section 197. Firstly, he states that the challenge cannot be resolved by a simple claim that the constitutional right to fair labour practices of employees would be protected through the creation of a greater protection for workers affected by outsourcing.⁴³⁴ The constitutional right to fair labour practices is granted to 'everyone', and section 197 serves a dual purpose. Thus, a constitutional challenge on section 197 raises the question of how the extension of its scope impacts the balance of interests.⁴³⁵ If every outsourcing contract were to fall under the scope of a hypothetically amended section 197, employers could be overly burdened with the duty to retain employees in circumstances where neither law nor policy requires it.

To claim that the purpose of section 197 is to protect employment security, without any reference to the employer's countervailing rights is 'superficial and inadequate.'⁴³⁶ This also raises a 'floodgates' argument, where the extension of section 197's application could lead to a surge in litigation to establish when it does *not* apply. An extension of section 197 could furthermore upset the sensitive nature of labour law- which balances 'political and economic compromise between organised labour... and employers.'⁴³⁷ In this regard, Wallis comments that the Legislature deliberately chose the word 'by' in section 197(1)(b); and the fact that it has survived legislative amendment⁴³⁸ negates the suggestion that it is a 'drafting oversight'.⁴³⁹ Courts would also be cautious to traverse into the territory of the Legislature by deciding on what is fair or unfair in 'a matter of labour relations policy.'⁴⁴⁰ Thus, labour practices, the content of fairness,

⁴³⁴ M Wallis op cit note 10 at 798.

⁴³⁵ Ibid at 799.

⁴³⁶ Ibid at 802.

⁴³⁷ *RE Public Service Employee Relations Act (Alberta)*: (1987) 38 DLR (4th) 161, at 232-3. Found in Cheadle et al, 'South African Constitutional Law: The Bill of Rights' (2002), at 18-15.

⁴³⁸ Through the Labour Relations Amendment Act of 2002, and the Labour Relations Amendment Bill of 2012.

⁴³⁹ As suggested by Bosch in his article, 'Balancing the Act', op cit note 49 at 930.

⁴⁴⁰ M Wallis Op cit note 10 at 799.

and the mechanisms for determining fairness have been described as ‘political choices that ought to be left to the legislature.’⁴⁴¹

Wallis does nonetheless acknowledge the potential success of a constitutional claim that the LRA as a whole fails to give effect to the constitutional right to fair labour practices by failing to protect employment security in situations of second generation outsourcing.⁴⁴² However, the author’s suggestion goes beyond the scope of section 197 or even employees involved in second generation outsourcing, as his inquiry questions the entire labour law framework’s adequacy in protecting fair labour practices.⁴⁴³ He argues that unless the entire framework is found to be inadequate first, a constitutional challenge will fail. However, the broad nature of this inquiry could potentially obscure or alter the issues raised in this paper, as it opens up the inquiry to the interpretation of every provision in the LRA. The bar for an order of unconstitutionality ‘is very difficult to clear’.⁴⁴⁴ Thus, it is difficult to envision the CC finding in favour of an applicant who claims that the wording of section 197(1)(b) is unconstitutional.

8. Conclusion

This paper has endeavoured to analyse whether the judicial interpretation of section 197 with particular reference to outsourcing cases upholds or subverts the provision’s purpose. Filling in the gaps left by the common law, the purpose of the section lies in between assisting employers by facilitating a smooth transfer process, and protecting the right of employees to job security in the face of a change in employer.⁴⁴⁵ However, where there is ambiguity when the section is interpreted, it is submitted that the protection of employment security should be given preference, as courts have a duty to balance the unequal distribution of power that characterises the employment relationship. Thus, when interpreting the section, a court should give due regard to the purpose of section 197, particularly in light of its role in giving effect to the constitutional right to fair labour practices. A purposive interpretation entails placing section 197 in the context

⁴⁴¹ H Cheadle et al p cit note 437.

⁴⁴² M Wallis op cit note 10.

⁴⁴³ Ibid.

⁴⁴⁴ Ibid at 804.

⁴⁴⁵ Supra note 65 at 45.

of the purpose of LRA as a whole; giving effect to the right to fair labour practices in section 23 of the Constitution; complying with public international law obligations; and referring to foreign jurisprudence in areas of uncertainty. Furthermore, a purposive interpretation of section 197 gives greater weight to the substance of the facts before a court, and not a form-based approach, where certain types of transaction or businesses (or part thereof) are excluded from the provision's ambit.

The inquiry of when section 197 applies has not been easy to carry out due to the incoherent manner in which the principles of interpretation and application have been set out by the judiciary. This paper does however acknowledge that section 197 is inherently problematic because it necessitates a case by case factual analysis; therefore one cannot set hard and fast rules on how to establish when the section's requirements have been satisfied. This is best illustrated by the CC judgment in *Aviation Union*, which is currently the highest authority on the relationship between section 197 and business transfers through outsourcing. Despite the fact that the CC judgment instructed courts to interpret section 197 in a manner which purposively gives effect to the provision's purpose in facilitating business transfers and protecting employment security, one cannot ignore that the particular facts of the case played the pivotal role in the case.

The applicability of section 197 is dependent on there being a transfer of an identifiable business by the old employer to the new employer as a going concern. This can only be ascertained with reference to the facts of a case. One cannot adequately distinguish between cases that fall under section 197, and those that fall outside of its reach without a sufficient factual inquiry, especially when it involves an outsourcing business. In determining whether an entity amounts to a business, the various components of the entity need to be scrutinised in order to establish whether they constitute an entity which is capable of transfer. The nature of the entity is important in determining the weight to be attached to the presence or absence of certain components.

It is also submitted that the word 'transfer' should be interpreted as generously as possible, as section 197(1)(b) allows for a wide range of transactions to fall within the provision's scope. Section 197(1)(b) should be interpreted in a manner that gives effect to employees' rights to employment security as much as is reasonably possible. However, it is submitted that the dual

nature of section 197 should always be borne in mind, and employers should not be overburdened with the obligations imposed by section 197 when the transfer does not amount to a transfer of a business.

In deciding whether a transfer of a business is carried out as a going concern, courts should focus on the substance and not the form of the case. The transfer of assets and employees is inconsequential to the inquiry. Furthermore, whether the transfer was carried out in a first or second generation outsourcing contract are is of no relevance. This paper suggests that the distinction between first and second generation outsourcing should be done away with. As long as an entity capable of being a business is transferred to a new employer by the old employer, and it maintains its identity (with reference to the nature of the business) after transfer, there has been a transfer of a business as a going concern. The implication of this reasoning on the transfer of franchise businesses is not certain. This paper submits that although there may be room for the transfer of a franchise business by one outsourcee to another to fall under section 197, the law currently indicates that such businesses fall outside the scope of section 197.⁴⁴⁶

This paper submits that the claim that section 197 in its current form is inadequate is misplaced. The true problem is the absence of a sound line of precedent on how to interpret the section. It is suggested that the solution does not lie in replacing ‘by’ with ‘from’. A construction of a statutory provision by a court would not be reasonable if it is reached ‘only by distorting the meaning of the expression being considered.’⁴⁴⁷ The fact that the word ‘by’ has been kept by the Legislature also indicates that the use of the word is not the problem where the applicability of section 197 is concerned. Furthermore, the hypothetical amendment of section 197 to explicitly include first or subsequent generation outsourcing contracts will not reduce the difficulties in applying the section. The inquiry will still have to be factually dependant, with certain cases falling outside the zone of applicability. Thus, it is submitted that the future of the efficacy of section 197 in protecting employee’s rights to job security rests with the courts. A constitutional

⁴⁴⁶ F Coetzee et al, ‘Section 197 of the Labour Relations Act — Some Comments on Practical Considerations when Drafting Agreements’ (2013) 34 ILJ 1658, at 1662.

⁴⁴⁷ *National Coalition for Gay and Lesbian Equality and Others v Minister of Home Affairs and Others* 2000 (2) SA 1 (CC) (2000), at para 23.

challenge is unlikely to succeed, and legislative amendment of the provision is clearly not on the Legislature's agenda.

In summation, this paper suggests that the purpose of section 197 is subverted to the extent that courts apply a formalistic interpretation of the business transfer provision. There still exists a form-over-substance interpretation of section 197, resulting in unnecessary litigation and extensive debate on matters that should be ancillary to the application inquiry. It is submitted that the structure built around litigation in labour matters facilitates swift, efficient and inexpensive resolution of disputes. However, a significant amount of the cases discussed in this paper have been in the SCA and the CC. The dissensus on the meaning of section 197 has resulted in litigants taking the matter on appeal; with the appeal courts often yielding different results to the courts *a quo*. It is submitted that courts, particularly the LC, need to apply an objective, fact-driven approach to section 197, without reliance to the type of transaction being analysed. In conclusion, the judgment set by the CC in *Aviation Union* sets a commendable precedent in how to interpret section 197. However, the extent to which the precedent will be followed in subsequent cases (given the peculiar facts before the CC *in casu*) is unknown.

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