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Mergers and Acquisitions and the Resultant Ramifications on Employees in the Transaction

A study of South Africa's Section 197 Labour Relations Act 1995 as amended in 2002

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

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A. Outline

Business organizations engage in mergers and acquisitions (M&As) to accomplish various objectives, including, but not limited to, increasing growth potential, expanding product lines, entering new markets at a faster speed, eliminating competitors gaining access to intellectual capital and gaining desired technologies.[1] M&As have lately also been undertaken as a means of business reorganization.

Few observers contest the right of companies to engage in M&A activity in order to strengthen their market positions. The criticism of mergers and acquisitions rests more with the manner in which they are planned and executed, almost always excluding the most affected group of stakeholders – the employees – although these usually pay the heaviest price: potential job destruction and eroded working conditions with few, if any, compensatory benefits. Trade unions and other critics also note that the high cost in terms of loss of jobs is pointless, since most M&As fail to achieve their stated objectives, and in fact, destroy shareholder value, the reason most proffered these days for embarking on M&A transactions.[2]

Opponents of mergers generally concede the difficulty of separating their effects on employment from such other factors as increased competition, automation or the introduction of new technologies, which similarly push enterprises to restructure, or simple restructuring that can happen with or without M & A-related integration. They contend, however, that mergers usually provide the justification for and facilitate organizational downsizing because combining two enterprises creates overlapping functions that can be compressed, while duplicated operations can be trimmed, resulting in job losses at levels of the new organization.[3]

South Africa, with its developed financial markets, which facilitate the sale and purchase of companies and company assets, is the only country in the region to experience significant merger activity over recent years. Information provided by the South African Commercial, Catering and Allied Workers Union (SACCAWU) suggests that merger

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[1] Baro Ginny A, *Mergers and Acquisitions: An IS/T Perspective,* 2004, p. 4.
[2] Report for discussion at the Tripartite Meeting on the Employment Effects of Mergers and Acquisitions in Commerce, Geneva, 2003. International Labour Organization, P.3.
[3] *ibid.*

activity has been very heavy in South Africa. It is estimated, for instance, that over the first six months of 2002, about 124 deals worth approximately US$22.6 billion were concluded, as compared with 183 transactions for the whole of 2001.[4]

Mergers in South Africa, as indeed elsewhere, are primarily motivated by business considerations, and often take scant account of employment and labour issues.[5]

Traditionally, merger refers to the combination of two companies, while acquisition suggests the take over of one firm by another.

However, in more recent times, this notion has changed to include more complex tendencies; for e.g. a business may transfer a part of itself, a part that is not the core concern of the business at hand, and capitalizing on its strategic strength, thus 'concentrate on the knitting'. This has been engendered by a shift from the age of the conglomerate, where businesses coveted to become a "one stop shop", wherein they tended to be self sufficient in their operations, and adoption of business theory that necessitates concentration on core operations in the business at hand. A necessary concomitant of that view is to dispose off parts that do not fit the new strategic path, or alternatively acquire a business that reinforces that strategic strength. Conversely, plain old cost cutting may be applicable, particularly in the case of peripheral services, rather than tie up capital and management in such activities and thereby loose focus; it is preferable to buy the service from somebody else whose strength is the provision of such services. This form of restructuring called outsourcing has grown exponentially in popularity.[6]

Under common law, closure or transfer of a business resulted in the termination of the contracts of employment. In most cases, employees had to accept new terms and conditions of employment with the transferee at whatever terms were on offer. This is if they were lucky to hold on to their employment. In the sale of a business as a going concern, the court would generally follow the common law in that there was no transfer

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[4] Report for discussion at the Tripartite Meeting on the Employment Effects of Mergers and Acquisitions in Commerce, Geneva, 2003. International Labour Organization, p. 20.
[5] *ibid*
[6] R R G Thorp *Business Restructuring and Labour Law,* 2005, p. 27.

of employment contracts. It did not require the seller to consult the employee in question and involve the purchaser where appropriate.

To regulate the transfer of a going concern, Section 197 of the Labour Relations Act, 1995 was enacted. The purpose of Section 197 has been touted as a boon for the employer, in that, on sale of a business as a going concern, transfer of employees will go to increase the value of a business. However, in the real sense this section was enacted to protect the employees against unfair labour practices ergo, unfair dismissal. In this sense, the section serves "a dual purpose, it facilitates the transactions while at the same time protecting the workers against unfair job losses."[7]

[7] *The National Education, Health and Allied Workers' Union v University of Cape Town & others* (2003) 24 *ILJ* 95 (CC)

B. Table of Contents

1. Transferring employees as a result of a sale of business in the United Kingdom and South Africa

In the event one company acquires another, either by purchase of the assets or the shares of the company, the purchaser will often restructure certain areas of the newly acquired company and this will inevitably have an effect on the current employees of such a company. However, the purchaser will not be permitted to pick and choose what employees stay on with the newly acquired company and the terms under which those employees remain employed.

The legal position pertaining to the ramifications befalling employees in the United Kingdom and South Africa is set out hereunder.

1.1 United Kingdom

The relevant legislation governing employee transfers in the United Kingdom is the Transfer of Undertaking (Protection of Employment) Regulations 2006 ('TUPE 2006') which came into force on 6 April 2006, replacing the 1981 TUPE Regulations. Prior to the implementation of TUPE, the position in the United Kingdom was that where there was no change in identity of the employer the employees' contracts of employment would continue un-amended. Therefore, if a company is acquired by purchasing the shares of that company there is no changed in the identity of the employer (as it remains the same company) and consequently no change in the employees' contracts of employment. However, where the business is purchased by an asset sale the original UK common law position was that the employees were left behind and the purchaser was entitled to pick and choose what employees it would offer employment to and the terms of such employment.

TUPE altered this common law position by providing that where an asset sale amounts to the transfer of a business as a going concern, all rights, duties and liabilities in relation to the acquired company's employees are transferred with the business. The

purchaser is therefore obliged to continue with the employment of such employees on their current terms and conditions of employment.

TUPE protects employees against any changes to their terms of employment which are connected to the transfer even if the employees agree to such changes. The only exception to this rule, are changes that are economic, technical or organizational reasons (ETO reasons; e.g. a reason relating to profitability, production processes or structure) entailing a change in the numbers, functions or place of work of the employees. While TUPE 2006 has relaxed the provisions dealing with amendments to employees' terms of employment where the selling business is subject to certain insolvency proceedings, the proposed changes must still be agreed with a representative of the relevant employees.

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

1.2 South Africa

In South Africa, as in the United Kingdom, if a company is acquired by purchasing the shares of that company there is no change in the identity of the employer and consequently no change in the employees' contracts of employment. However, should a company be acquired by way of an asset purchase then such purchase will be subject to Section 197 of the Labour Relations Act, 1995 ('the LRA') which governs transfers of contracts of employment on the sale of a business as a going concern. Section 197 provides that if the whole or part of a business is transferred as a going concern to a purchaser then the purchaser is automatically substituted in the place of the old employer (the seller) in respect of all contracts of employment in existence immediately prior to the date of the transfer. This means that anything done before the transfer by or in relation to the old employer is considered to have been done by the new employer (the purchaser),

although the old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to the transfer. However, liability of criminal actions will remain with the entity responsible for such actions.

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

Where the new employer employs the transferring employees on terms and conditions that are less favourable and an employee resigns as a result thereof, such a resignation will be regarded as an unfair dismissal by the new employer.

Section 197 also requires the old employer to conclude a written agreement with the new employer setting out the amounts and which employer (the old or the new) will be liable for accrued leave pay, severance pay that would have been payable to the transferred employees in the event of a dismissal by reason operational requirements and any other payments that have accrued to the transferred employees but have not yet been paid by the old employer.

Regardless of whether the entity to be purchased is carried on in South Africa or the United Kingdom and regardless of whether the transaction is carried out by means of an asset or a share purchase, purchasers will take over the rights, obligations and liabilities of the seller in regard to their employees. While there are certain differences that exist in both South Africa and the United Kingdom between asset and share purchase, whatever route a purchaser decides to take it will require adequate warranties and indemnities in

the purchase agreement as well as comprehensive due diligence in order to highlight any onerous liabilities that the selling company may possess.

2. Transfer of a business as a going concern

The transfer of a business is usually given effect to by the sale of shares or the assets of the business as a going concern.[8]

In the case of sale of shares, the identity and nature of the employer is not affected, nor is continuity of employment necessarily prejudiced. The transaction amounts to passing ownership of the business from the seller to the purchaser. The employment relationship is not altered and the employees of the affected business will continue to be employed by the same employer. The Labour Relations Act, 1995 did not bring about any change in an employer's obligations in respect of such a transaction.[9]

In instances where the business is sold as a going concern, where the assets and goodwill are sold, the employment obligations of the seller or transferor are affected. Under the common law, a contract of employment is not capable of cession without the consent of the employee.[10]

The reason for this limitation is the protection of the employee's freedom to choose whom the employee wishes to serve. The common law does not adequately protect employee's rights in such instances. The Labour Relations Act, 1956, under its unfair labour practice jurisdiction, developed a set of obligations which required the seller/transferor to consult with employees concerning any proposed sale as if it were a retrenchment.[11]

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[8] Brian Patterson, *Transfer of Business – Where to Now?* Accessed on www.deneysreitz.co.za on 27/04/2007
[9] *ibid.*
[10] *supra* note 8.
[11] *supra* note 8.

Section 197 of the Act makes a major inroad into the common law prohibition on the transfer of an employee's contract of employment without the employee's consent. Section 197 has, in effect introduced a form of statutory assignment (a cession and delegation of rights and obligations) without the employee's consent.[12]

Transfer of business evokes special interest in labour law in that it impacts directly on employment contracts. With the foregoing in mind it is inherently prudent that employees concerns are addressed. Although mergers and acquisitions are predominantly commercial activities and therefore guided by the Companies Act, the outcome in these transactions impact greatly on the employees in participating firms, especially the acquired or transferred business. This is the main reason why Section 197 of the Labour Relations Act, 1995 was formulated and enacted; to protect the employees therein.

While sale of a business as an operating entity has normally qualified, it is uncertain whether the outsourcing of an enterprise to a contractor without selling it constitutes the transfer as a going concern.[13] This brooks the question: Can outsourcing of non-core operations of a business then constitute "going concern" transfer in terms of Section 197?

This uncertainty emanates from the contradictions in court decision on this issue. In the case of *NEHAWU v UCT*[14], the Labour Court found the outsourcing of cleaning, maintenance and gardening functions did not constitute the takeover of a going concern; and in *SAMWU v Rand Airport Management Company*[15], the court found that the transfer of part of an employer's structure that was not a recognizable entity did not constitute the transfer of a going concern. However, in the Labour Appeal Court in *SAMWU and others v Rand Airport Company*[16] overturned the earlier case decision; and the Constitutional

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[12] Brian Patterson, *Transfer of Business – Where to Now?*
[13] Ivan Israelstam, *Contractors suffer big blow in union victory*, p.2 The Star, August 08, 2005.
[14] *The National Education, Health and Allied Workers' Union v University of Cape Town and Others* (2000) 21 *ILJ* 1618 (LC).
[15] *SAMWU and Others v. Rand Airport Management Company (Pty) Ltd and Others* (2002) *ILJ* 2307 (LC)
[16] *SAMWU and Others v. Rand Airport Management Company (Pty) Ltd and Others* (2004) 13 (LAC) 1.16.4.

Court in *NEHAWU v University of Cape Town*[17], overturned the earlier decision, respectively.[18]

In these two appeals, the issue hinged on the definition of "business" contained in Section 197 (1). This issue is dealt with in subsequent chapters.

In *COSAWU v Zikhethele Trade*, the labour court has now taken the prior outsourcing decisions one step further in finding that the takeover of a contract by one contractor from another constituted the takeover of a going concern.[19]

The above mentioned cases shall all be delved into more elaborately in a subsequent chapter.

Consistently from the above discourse it was thus concluded that a transfer of part of a business would be a transfer of a going concern if that part of a business is an identifiable entity that continues to function and retains its identity after transfer. This deduction shall be strung out in the following chapters.

This being said and as an example, if an insurance company outsources its canteen to a private contractor that will be a transfer as a going concern unless the provision of services is dramatically changed.[20]

2.1 The Labour Relations Act

2.1.1. Section 197

South Africa has a comprehensive web of labour legislation designed to protect employees and to afford a measure of security of tenure. The Labour Relations Act (LRA) provides, under section 197, that employees' contracts of employment must be

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[17] *National Education Health & Allied Workers Union v University of Cape Town and Others Constitutional Court* (2003) 24 *ILJ* 95 (CC).
[18] Ivan Israelstam, *"Contractors suffer big blow in union victory"*.
[19] *ibid.*
[20] Paul Benjamin, *Still Misunderstood: Transfers, outsourcing and labour-broking.*

transferred from the seller of a business to the purchaser of that business. The drawback of the consequence of mergers within the context of this section 197 is that these mergers often result in surplus employees in the merged entity, precisely because of the operation of section 197.

Section 197 was based on the Acquired Rights Directive 77/187 EEC[21] promulgated by the European Parliament and the Transfer of Undertakings (Protection of Employment) Regulations, 1981[22] in the UK which gave effect to the EU Directive. As a consequence our courts have relied on the European jurisprudence on interpreting this section.[23]

The history and development of section 197 of the Labour Relations Act 1995, which is particularly relevant when dealing with mergers and acquisitions, is a glowing example of how employment law has had a profound impact upon commercial transactions. Critics of the statutory regulation of employment rights in mergers and acquisitions contend that the restrictions imposed by section 197 of the LRA unreasonably limit economic development.[24]

The former section 197[25] of the Act, which regulates employment rights in circumstances where a business is transferred, clearly demonstrated that notwithstanding the particular wording of the provision, the South Africa Labour Court was only too willing to interpret the provision to extend protection to employees when a business was transferred as a going concern and the interpretation of the former Section 197 of the Act went a full circle.

> 'In getting in grips with section 197 of the LRA the courts have repeatedly stated that this section must be given a purposive interpretation. The Constitutional Court has held that the purpose of section 197

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[21] The preamble of the Acquired Rights Directive fixes the goal of the Directive "to provide for the protection of employees in the event of a change of employer, in particular to ensure that their rights are safeguarded".
[22] This has been discussed here in the first chapter of this thesis.
[23] Report for discussion at the Tripartite Meeting on the Employment Effects of Mergers and Acquisitions in Commerce, Geneva, 2003. International Labour Organization, p. 28.
[24] St. Elmo Wilken *Essential Employment Law Aspects Impacting Upon Mergers and Acquisitions.*
[25] Labour Relations Act (66 of 1995).

of the LRA is to protect the employment of employees and to facilitate the sale of businesses as going concerns by enabling the new employer to take over the workers as well as the other assets in certain circumstances'.[26]

The purpose of section 197 of the LRA is stated as;

'...to facilitate commercial transactions whilst at the same time protecting workers against unfair job losses'.[27]

The Labour Relations Amendment Act of 2002, which came into force on 1st August 2002, settled the controversy that reigned since the introduction of the statutory regulation of employment rights when a transfer of a business as a going concern occurred. The amendments are welcomed in that many aspects that were controversial as well as impractical to implement are now addressed.[28]

There were four key aspects to section 197 (LRA 66 of 1995), namely:

- Does it operate automatically or is an agreement between the seller and the buyer required before it kicks in?
- If it operates automatically, what types of transactions does it apply to?
- What are the consequences of the application of the section?
- Can one avoid the section by retrenching the affected workers prior to the transfer?

The answer to these questions depends on the interpretation of section 197, more particularly 197(1) (a) and 197(2) (a), and section 189[29]. This shall be dealt with in turn to allow for the requisite elaboration.

Going by the above mentioned points and headed thus we refer to them as hereunder;

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[26] St. Elmo, *"Second Generation Transfers – The Outsourcing Debate Continues"*. Accessed on www.deneysreitz.co.za on 2/06/2007

[27] *National Education Health & Allied Workers Union v University of Cape Town and Others Constitutional Court* (2003) 24 *ILJ* 95 (CC).

[28] St. Elmo Wilken, *"Essential Employment Law Aspects Impacting Upon Mergers and Acquisitions"*.

[29] Hermann Nieuwoudt, *"Transfer of Contracts of Employment"*. Accessed on www.deneysreitz.co.za on 27/04/2007.

Does it operate automatically or is an agreement between the seller and the buyer required before it kicks in?

The common law position is that the rights and obligations in terms of a contract of employment may not be transferred from one employer to another without the consent of the employee. This is very much what subsection 197(1) seems to say[30]:

"Transfer of contract of employment"

(1) "A contract of employment may not be transferred from one employer (referred to as "the old employer") to another employer (referred to as "the new employer") without the employee's consent unless..."[31]

Paragraph (a) then creates an exception to the common law position and permits the transfer of a contract of employment without the consent of the employee under certain defined circumstances, namely:

(a) [when] the whole or any part of a business, trade or undertaking is transferred by the old employer as a going concern; or...."[32]

Approached in the above fashion the section seems to be quite straightforward and uncontroversial. Employers are allowed to transfer contracts of employment without the consent of the employees concerned if they dispose of their business or part thereof, provided that they do not try to amend the employees' conditions of employment or length of service.[33]

However, this approach does not suit trade unions. They contend that the section is a worker protection provision. Accordingly, it should be interpreted to mean that the contracts of employment of all employees transfer automatically where the seller transfers a business to a buyer.

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[30] Hermann Nieuwoudt, *"Transfer of Contracts of Employment"*.
[31] Section 197(1) Labour Relations Act (66 of 1995)
[32] *ibid* section 197(1) (a).
[33] *supra* note 30.

The Unions contend that the words "If a business is transferred in the circumstances referred to in subsection (1) (a)" in section 197(2) (a) actually only refer to paragraph (a) of subsection (1), and not the whole of subsection (1) (a). So interpreted, the section does become a worker protection provision as it is clear that the rights and obligations between seller and the employees transfer to buyer unless it is otherwise agreed.[34]

The amended section 197 settles this issue. It provides that the buyer is automatically substituted in the place of the seller in respect of all contracts of employment in existence immediately before the date of transfer.[35]

What type of transaction does the section apply to?

An analysis of subparagraph (a) shows that the section applies to transactions where

- the whole or any part
- of a business, trade or undertaking [or service]
- is transferred
- as a going
- concern.[36]

These requirements are dealt with in a latter section. However, in a nutshell this transaction basically deals with a business which is sold, transferred or otherwise disposed off as a going concern.

What are the consequences of the application of this section?

The amended section spells out that, unless otherwise agreed with the union (if union members are affected), or otherwise with the affected employees:

- all the rights and obligations between the seller and each employee continue between the buyer and each employee;
- anything done by the seller will be construed to have been done by the buyer;
- the employment of the employees continues with the buyer as if with the seller;

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[34] Hermann Nieuwoudt, *"Transfer of Contracts of Employment"*.
[35] Section 197(1)(a) Labour Relations Act 2002
[36] *supra* note 34.

- the buyer and seller are jointly and severally liable in respect of any claim, concerning a term or condition of employment, that arose prior to the transfer;
- if the employees are retrenched within twelve months after the transfer, the seller is jointly and severally liable with the buyer for leave pay, severance pay and other payments that have accrued at the date of transfer; and
- the provision of substantially less favourable terms and conditions of employment by a buyer constitutes a dismissal.[37]

These have important implications for buyers of a business; that is, do a proper due diligence, insist on indemnity by the seller, make sure all accrued rights like leave pay, have been factored in, in the purchase price, take note that if you retrench in the future you are liable to pay severance for all years of service with the seller and cannot accordingly vary this obligation by agreement and also, bear in mind that if your terms and conditions of employment are less favourable than those of the seller, you will have to negotiate in order to equalize them and you may face a strike or an unfair dismissal claim.

Can one avoid the section by retrenching the affected workers before the transfer?

European law prohibits a dismissal if the reason for it is the transfer of a business. However, there is an important exception. A dismissal based on the organizational requirements of either the buyer or the seller is not prohibited.[38] The South African LRA also does not expressly prohibit such dismissals. In fact, there is no link between section 189, dealing with retrenchments, and section 197. Thus, the test for a fair retrenchment remains whether the dismissal is for a fair reason based on the operational requirements of the employer.[39]

Operational requirements mean requirements based on the economic, technological, structural or similar needs of an employer. This should include the fact that the buyer does not require the employees or that he does not require them at their existing terms or conditions of employment.

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[37] Hermann Nieuwoudt, *"Transfer of Contracts of Employment"*.
[38] *ibid.*
[39] *supra* note 37.

However, take note that the amendments provide that the dismissal of an employee for a reason related to a transfer in terms of section 197 is automatically unfair. It seems as if the lawmakers have decided that the operational requirements of the buyer and the seller are irrelevant and that the buyer must be stuck with the employees of the seller. This has been reflected in the Labour Appeal Court decision in the *NEWAHU v University of Cape Town*[40] case.

2.1.2. Why Section 197?

In the outline of this paper, reference was made to the dual purposes that section 197 serves. This issue has now been resolved by the Constitutional Court's findings in *NEHAWU v University of Cape Town*[41]. The section facilitates commercial transactions by allowing a species of legal transaction not permitted at common law – the transfer of a contract of employment from one employer to another.

It protects employees by preventing employers relying upon a transfer of any part of its business (whether by outsourcing or any other commercial arrangement) to another employer as a basis for retrenching. At the same time, it provides that where a transaction such as outsourcing occurs, that transaction cannot be used as a basis for reducing terms and conditions of employment, or in any way altering them to the detriment of the employee. This section provides that a transfer will not be used to save on labour costs and thus forestalls any use of outsourcing and similar transactions as a basis for gaining competitive advantage. Section 197 is seen as preventing two employers from doing what one employer cannot do, in the process of a transfer of a business as a going concern.[42]

Now this law is no longer in contention that, any transaction involving the transfer of a business or part of a business as a going concern, results in the contracts of employees being automatically transferred to the new employer. Unless employees agree not to be

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[40] *National Education, Health and Allied Workers' Union v University of Cape Town and Others* (2002) 23 *ILJ* 306 (LAC).
[41] *National Education Health & Allied Workers' Union v University of Cape Town and Others* Constitutional Court (2003) 24 *ILJ* 95 (CC).
[42] Paul Benjamin, *Still Misunderstood: Transfers, outsourcing and labour-broking.*

transferred, the new employer receives the employees on their existing terms and conditions of employment and must comply with any collective agreement or organizational rights applicable to those employees.[43]

Invariably, it may be so that employees no longer have the choice not to be transferred if employers want to transfer them. But, they are better off, because their jobs are protected, they have a right to be transferred, and all of their existing terms and conditions must be recognized by the purchaser, unless of course, the employees agree otherwise.

All in all section 197 offers some protection to affected employees by stating that whilst the terms of transfer need not be identical, they must, on the whole not be less favourable than those enjoyed when employed by the old employer. Employees may object to the terms of their transfer if they are able to show that the terms of transfer are less favourable than those which governed their employment with the old employer or if their employment is terminated by reason of a transfer or for reasons related to the transfer as contemplated in terms of section 197.[44]

2.2 Scope of Regulation

The Act regulates both solvent [Section 197] and insolvent transfers [Section 197(A)]. The Act only applies in instances where a business is transferred as a going concern. A business includes the whole or part of any business, trade, undertaking or service. A 'going concern' is not defined in the Act. The South African Labour Courts have in the past relied heavily on European Court authority with the interpretation of the term 'going concern'.[45] Relying on such authority, a transaction whereby an undertaking is actually continued or resumed by the new employer with the same or similar activities as the old employer will constitute a transfer as a going concern.[46]

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[43] *supra* note 42.
[44] St. Elmo Wilken, *Sweeping changes to transfers of business.*
[45] *Schutte and Others v Powerplus Performance (Pty) Ltd and Another* (2000) 20 *ILJ* 655 (LC)
[46] *Spijkers v Gebroeders Abatoir* CV 24/85 1986 (2) CMCR 296

It is generally accepted that a merger or acquisition that only concerns the acquisition of shares has no employment law consequences. Accordingly, the Act is not intended to regulate mergers or acquisitions that are obtained through the acquisition of shares only.[47]

As we mentioned in the preceding chapters, when deciding whether section 197 applies in the case of a business transfer there are three initial tests to be applied;

1. did a transfer take place?
2. of a business
3. as a going concern

In applying these tests as per the European jurisprudence, substance takes precedence over form and it is not what the parties agreed to but what the actual impact was.

In the issue of whether a transfer took place it is instructive to look at the local jurisprudence. In *Schutte and others v Powerplus Performance (Pty) Ltd and other*[48] a car rental company transferred its workshops to a new entity in which it took a 50% interest. Employees were told to apply to the new entity and those who did not accept the new conditions of employment were retrenched. The court regarded those parts of the agreement between the parties regarding the transfer of employees, stock and equipment and the sharing of premises as support of the fact that a transfer had taken place. In support of that notion it noted that the service had continued uninterrupted and management staff was also transferred.

2.3 Section 197: Requirements

2.3.1 Transfer as a going concern

The term "transfer" includes all transactions in which a business or an identifiable part of a business is transferred from one person to another. In deciding whether such transfer has occurred, the court must look at the substance of the transaction and not merely its form. These are activities taking place under the aegis of a merger or a take

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[47] *See* Chapter 2, *Transfer of a business as a going concern*, para. 2 (in this thesis).
[48] *Schutte and Others v Powerplus Performance (Pty) Ltd & another* (2000) 20 *ILJ* 655 (LC)

over. However, not all takeovers fall under this legislation because not all are transfers 'as going concerns'.[49]

Consequently, it is essential for employers to know which transfers do and do not fall under this legislation because they need to know whether the new employer will be forced to take over all the old employer's employees and whether the new employer will have to recognize and preserve all the benefits, remuneration, working conditions, years of service and other rights of employees.[50]

Where the obligations of the old employer transfer automatically to the new employer, no prior consultation or negotiation with employees is required. But, where any terms and conditions of employment or any obligations are to be altered, either the old employer, the new employer or the old employer and new employer acting jointly will be obliged to engage in negotiations on the terms of such changes with the trade union representing the employees affected, or in the absence of such trade union, the employees themselves.[51]

While section 197 defines a transfer[52], the LRA does not define what a transfer 'as a going concern' is[53]. This causes great confusion and sparks many disputes between employers on the one hand and employees and trade unions on the other. That is, takeovers often cause loss of jobs and employees are often desperate to stay on with the new enterprise. On the other hand, the new entity very often already has its own staff and wants to avoid the expense of taking on additional employees. However, the statutes are not clear enough to inform the parties which new entity must or must not comply with section 197 of the LRA.

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[49] Ivan Israelstam, *Taking over someone else's business has its pitfalls.*
[50] *ibid.*
[51] St. Elmo Wilken, *Sweeping changes to transfers of business.* Sourced from www.deneysreitz.com on 20/10/2007.
[52] Section 197(1) (b) provides 'transfer means the transfer of a business by one employer (old employer) to another employer (the new employer) as a going concern'.
[53] *NEHAWU v UCT* (CC), *supra* note 41.

In coming to terms with what constitutes a "going concern" the Constitutional Court echoed the views of the Labour Appeal Court in holding that this phrase must be given its ordinary meaning because the context does not indicate otherwise. Both the Labour Appeal Court and the Constitutional Court relied heavily on learning from the European Court of Justice when formulating what constitutes a "going concern" and accepted that a transfer as a going concern occurs when:[54]

> 'What must be transferred must be a business in operation so that the business remains the same but in different hands'.[55]

The South African courts accept that what constitutes " a going concern" is a matter for objective determination depending on the circumstances of each transaction bearing in mind, as we have mentioned previously, that regard must be had to substance and not to the form of the transaction.[56]

A guideline as to what circumstances would likely to characterize a merger or takeover as the transfer of a going concern is given as below:

- Where the transfer agreement itself labels the takeover as 'a transfer of a going concern' this would be significant;
- Where the new entity took over the assets of the old and continued to serve the same users, clients or customers of the business served by the old, this would indicate a section 197 transfer;
- If the new undertaking continued the running of the business as a going concern in much the same way as it has been run before, this would point to the takeover of a going concern.
- Such a takeover would also be likely to qualify if the new undertaking served the same clients or the same client market as did the old undertaking; and

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[54] St. Elmo," *Second Generation Transfers – The Outsourcing Debate Continues*".
[55] *National Education, Health and Allied Workers' Union v University of Cape Town and Others* (2002) 23 *ILJ* 306 (LAC).
[56] *ibid* note 54.

- Where a section of an undertaking is transferred this could also qualify as a takeover of a going concern even if that section was not a distinct legal entity.[57]

As we have seen above, section 197, LRA, applies to the transfer of the whole or part of a business, trade or undertaking or service from one employer to another if the business is transferred as a going concern. In circumstances where assets alone are transferred and the business is not continued, protection under section 197 and 197(A) and does not apply. Section 197 of the LRA deals with those circumstances where the undertaking being transferred is solvent, while section 197(A) deals with those circumstances where the undertaking being transferred is insolvent.

The South African courts have relied heavily on European Court authority in grappling with the interpretation of the term "going concern". Herein, it is considered a transaction whereby the undertaking is actually continued or resumed by the new employer with the same or similar activities as the old employer will constitute a "going concern".

2.3.2. Business: Whole or part.

Another important issue in the application of section 197 is what constitutes "part" of a business. As indicated earlier, the section applies where there is the transfer of a "business". According to the definition in section 197(1) "business" includes 'the whole or part of any business, trade, undertaking or service'. But it cannot apply to the transfer of any piece of a business, to some assets, for example. This raises the question of *when* a portion of an enterprise constitutes "part" of a business as envisaged by section 197(1).

In *SAMWU & others v Rand Airport Management Co. (Pty) Ltd & others*[58] the court found that the garden services, so outsourced, did not constitute "part" of a business. The court professed to have 'some difficulty in conceiving that a support function, as necessary as it may be, ordinarily constitutes a business or a part of a business. [Not that}

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[57] Ivan Israelstam, *Taking over someone else's business has its pitfalls.*
[58] (2002) *ILJ* 2307 (LC.

the door is closed, merely that, read with the concept of a going concern, it may be more difficult to find this to be so. But each case must be evaluated on it own merits'[59] the court found that the garden services could not be viewed as part of a business because:

- The gardening function formed part of (the broader) maintenance services.[60]
- The garden services were part of the non-core activities of Rand Airport Management Co.
- Gardening services was not an "entity". It had no separate management structure, none of its own goals, no assets, no customers and no goodwill. It was merely an activity, not intended to make profit or gain some other advantage.

This was deemed to be a narrow interpretation of section 197, effectively excluding non-core support services from the ambit of the section. It effectively requires that every section 197 "part of a business" be a business in its own right. Those parts of the business that exist merely to fulfil a support function fall to be excluded. Given that the definition of the word "business" in section 197(1) contains the reference to "business" and "trade" which are of a commercial and profit-seeking nature, however, the same cannot be said of an "undertaking" or "service". And what constitutes a "business" for the purpose of the section is broad in meaning. These considerations are arguably indications of the legislature's intention to extend rather than limit the ambit of what qualifies as a "business" or "part of a business".[61]

The amendments to the LRA have thus greatly clarified both the new and old employer's obligations and the rights of employees in the case of transfer of a business, whether in part or in whole. Employers will be well advised not to overlook their obligations towards employees when concluding the acquisition of the whole or part of a business as a going concern. In particular, great care should be taken with respect to

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[59] *supra* note 58 at 1220.

[60] This could be assumed to mean that the garden services were "part of a part" and that in order for there to be talk of the transfer of part of the business of Rand Airport Management Co. maintenance services as a whole would have to transfer.

[61] Craig Bosch, *Business restructuring: some important labour law issues.*

potential liabilities contained in the agreement of purchase, which liabilities can only be properly gauged by an extensive due diligence exercise.[62]

Craig Bosch[63] gave a suggestion of what should be taken into account when deciding whether the relevant entity is part of a business for the purposes of section 197 as below:

- The entity must be 'an identifiable component or unit of a business, be it a division, a branch, a department, a store or a production unit',[64] something severable[65]
- Utilizing the terminology of the European Court of Justice, the entity in question must be sufficiently structured, 'an organized grouping of persons and assets' which facilitates the exercise of an economic activity i.e. support functions are covered.
- It is not necessary that the entity be a discrete profit centre. It need not be 'economically viable if conducted independently of any other commercial activity'[66]

> 'Applying these considerations there would appear to be no reason to find that the garden services in the *Rand Airport Management Co.* case was not "part" of the business'.[67]

The Constitutional Court stressed that one of the purposes of section 197 is to provide protection to employees during the uncertain processes of business restructuring.[68] A broader interpretation of what constitutes "part of a business" for the purposes of section 197 is more in keeping with that purpose.[69]

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[62] St. Elmo Wilken, *Sweeping changes to transfers of business.*
[63] Senior Lecturer, Faculty of Law, University of Western Cape.
[64] Wallis 'Section 197 is the Medium. What is the Message?' (2000) 21 *ILJ* 1 at 4.
[65] *Schutte v Powerplus Performance (Pty) Ltd* (1999) 20 *ILJ* 655 (LC) at 668.
[66] *Finance Sector Union of Australia v PP Consultants Pty Ltd* [1999] FCA 1251 at par 28. See also *CPSU, Community & Public Sector Union v Stellar Call Centres Pty Ltd* [1999] FCA 1224 at par 49 and *Gribbles Radiology Pty Ltd v Health Services Union of Australia* [2003] FCAFC 56 at par 31.
[67] Craig Bosch, *Business restructuring: some important labour law issues.*
[68] *The National Education, Health and Allied Workers' Union v University of Cape Town & others* (2003) 24 ILJ 95 (CC).
[69] *ibid* note 65.

3. Case Law

3.1. Rand Airport Case

In *SAMWU & others v Rand Airport Management Company (Pty) Ltd & others*[70], a summary of the case is given below:

In June 2002, Rand Airport indicated its intention to outsource its gardening and security functions to different companies as from 1 July 2002. In July 2002 Rand Airport distributed a letter to the security employees stating that their function 'will be outsourced in terms of section 197 of the LRA', effective 1 August 2002. On 1 August 2002, Rand Airport however issued notices to employees in the gardening and security services section indicating that they would be retrenched with effect from 31 August 2002 and advising them to apply for positions in the outsourcing company. The outsourcing company indicated that the terms and conditions of employment they would be offering the employees in gardening and security services would be different from those offered by Rand Airport. The Union applied to the Labour Court on an urgent basis for a declaration that the outsourcing of the security and gardening functions constituted transfers of businesses as going concerns as envisaged in the amended section 197 of the LRA, which came into force on 1 August 2002.

The issue underlying herein was: Does outsourcing constitute a transfer as a going concern under section 197 of the LRA? The Court held that a "part" of a business is "an identifiable component or unit of a business', a part severable from the entire enterprise. The Court noted that a support function, as necessary as it may be, should not ordinarily constitute a business or a part of a business. However, each case must be evaluated on its own merits. The Court further held that the purpose of section 197 is to protect employees in circumstances where the old employer would have dismissed them when disposing off its business and that the protection is only conferred where there is a transfer of a going concern. The Court referred to "transfer" as a 'functioning business with a prospect of continuing'. If there were to be a mere transfer of assets and no

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[70] *SAMWU and others v. Rand Airport Management Company (Pty) Ltd and others* (2002) *ILJ* 2307 (LC)

possibility to render a service, the purchaser would be saddled with employees and may or may not have any work for them to perform and would have to incur the cost of retrenching them thereafter. This, the Court held, was not what the legislature intended. The Court held that a "going concern" meant that the shop was 'being kept open instead of being closed up' and that the customers were being kept together, incase the purchaser intended continuing the business then he would be able to. The Court further held that in terms of the decision of the Labour Appeal Court in *NEHAWU v UCT & others*[71] a transfer of a business as a going concern in terms of section 197 can only occur when the buyer and seller agree to transfer all or most of the employees. The outsourcing of the gardening function did not constitute a transfer as a going concern *because the gardening function formed part of the maintenance function*[72]. This being a non-core activity of Rand Airport, gardening services were an entity in that it had no separate management structure, no own goals, no assets, no customers and no goodwill and it is not intended to make a profit or gain some other advantage.

The Rand Airport case was the first matter to come before the South African courts where the effect of the amended section 197 on transfers of businesses was interpreted. Regrettably this judgment did not assist in settling the issue on what constitutes a "going concern". It is instructive to note that the decision did not take the substance of the inclusion of "service" as falling within the scope of section 197 transfers. Gardening and security services were therefore not protected as should have been under the amended section 197 LRA (2002).

However, the Labour Appeal Court in *SAMWU & others v Rand Airport Management Company (Pty) Ltd & others*[73] overturned the earlier Rand Airport decision made by the Labour Court. In the appeal the LAC was required to consider whether the outsourcing of divisions of an employer that performed non-core services and whether the transfer of business falls under the provisions of section 197. The court also considered the meaning of service within the context of section 197.

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[71] (2002) 23 *ILJ* 306 (LAC)
[72] My italicization for emphasis.
[73] (2005) 3 BLLR 241 (LAC)

The LAC held that security and gardening services did constitute a service as contemplated in terms of section 197. The effect of this finding was that the gardening and security services were capable of being transferred in the manner contemplated in terms of section 197.

The next question that the court was required to consider was whether these services were indeed transferred and to do so the court was obliged to consider the phrase transfer of a business as "a going concern".

The court noted that the critical phrase "a going concern" is not defined in the act and this phrase has received intense judicial scrutiny. In *National Education Health and Allied Workers Union vs University of Cape Town* (2002) 23 *ILJ* 302 (LAC) it was held that, *inter alia*, there can be no transfer of the business as a going concern unless both the transferor and the transferee have agreed that the latter takes a former workforce over as well.

In the NEHAWU case the matter went to the Constitutional Court and the court held *inter alia*, that the fact that a seller and the purchaser of a business have not agreed on the transfer of the workforce as part of the transaction does not disqualify the transaction from being a transfer of a business as a going concern within the meaning of section 197.

Going concern therefore could include gardening and security services. The court rejected the argument that the intention of the transferor and the transferee is critical in determining the issue. The court therefore found that the outsourcing of the garden and security services constituted a transfer of a business or service as a going concern within the parameters of section 197. Any dismissal therefore of the employees prior to such a transfer would be regarded as an automatic unfair dismissal in terms of section 187 of the LRA.

The court also considered whether the outsourcing agreement between the old and new employees amounted to a transfer of the service as a going concern. The court held

that the agreement was upon implementation an agreement that would have attracted the application of section 197.

The employer in this matter has taken the LAC decision on appeal to the Supreme Court of Appeals and the matter is still outstanding. However the effect of this judgment seems to accord with the decisions of the European Court of Justice.

3.2. UCT Case

In 1997 the University of Cape Town (UCT) decided to outsource certain of its non-core activities which were performed by the members of the National Education, Health and Allied Workers' Union (NEHAWU). These activities were mainly cleaning, gardening and sports ground maintenance services. UCT appointed four contractors to perform these services.

Since the decision to outsource was bound to result in the loss of employment for the members of NEHAWU, UCT held consultations with it on the reasons for outsourcing and the possible dismissal of workers who were performing the services to be outsourced. Despite these consultations the dispute between UCT and NEHAWU remained unresolved. UCT went ahead with the implementation of outsourcing and retrenchment. It gave notice to some two hundred and sixty-seven workers of the termination of their employment and stated that retrenchment benefit would be paid. Not content, the workers tendered to continue their employment with UCT and to commence with the contractors when the transfer occurred.

UCT rejected this offer and invited the workers to apply for employment with the contractors instead. UCT had stipulated in its contract with the contractors that the latter should favourably consider the employment of the workers. Most of the workers accepted the invitation and a majority of those who applied were accepted. However, many workers did not continue working for the contractors for very long. Apparently, the contractors employed them on conditions less favourable than those on which they had been employed by UCT. In particular, they were paid far less than UCT had paid them.

NEHAWU subsequently brought an urgent application in the Labour Court seeking declaratory relief.[74] It sought an order declaring that:

(a) the outsourcing of the non-core activities was a transfer of a part of UCT's business, trade or undertaking as a going concern within the meaning of section 197(1)(a) of the LRA;

(b) the employment contracts of the affected workers were transferred automatically to the contractors in terms of section 197(2)(a) of the LRA; and

(c) the termination of the workers' employment contravened section 197(2) (a) and was of no force and effect.

The proceedings in the Labour Court

Mlambo J, who heard the matter in the Labour Court, took the view that section 197 does not provide for automatic transfer of contracts of employment in the case of a transfer of a business as a going concern. He expressed the view that the contracts of the employment can only be transferred without the consent of the employees if the seller and purchaser of the business agree that the contracts of employment will be transferred together with the business. *Mlambo J* disagreed with an earlier decision of the Labour Court in *Schutte and Others v Power Plus Performance (Pty) Ltd and another*[75] in which *Seady AJ* had concluded that:

(a) section 197 protects the workers against the loss of their jobs in the event of a transfer of a business in the circumstances contemplated in section 197(1)(a); and

(b) the contracts of employment are transferred automatically when a business is transferred in the circumstances set out in section 197(1).

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[74] Other relief not relevant to this discourse was also sought.
[75] 1999 (2) *BLLR* 169 (LC); 1999 (20) *ILJ* 655 (LC).

But *Mlambo J* was confronted with the decision of the Labour Appeal Court (LAC) in *Foodgro (A division of Leisurenet Ltd) v Keil*[76] where the LAC reached the same conclusion as *Seady AJ* both as to the purpose and the meaning of section 197. While expressing the view that the interpretation of section 197 in *Foodgro* is incorrect, he nevertheless considered himself bound by that decision.[77] However, on the facts he found that the outsourcing involved in this case did not amount to a transfer of a going concern as contemplated in section 197. He dismissed the application and made no order as to costs.

NEWAHU appealed to the LAC. UCT and one of the co-defendants – Supercare - cross-appealed only on the issue of costs.

The proceedings in the LAC

The majority of the LAC dismissed the appeal.[78] It took as its starting point the meaning of the phrase "going concern" in section 197 and held that a business is transferred as a going concern only if its assets, including the workforce, are transferred. As the majority put it,

> '[t]o say that there can be a sale of a business as a going concern without all or most of the employees going over is to equate a bleached skeleton with a vibrant horse.'[79]

The transfer of a business as a going concern, the majority held, requires a prior agreement between the transferor employer and the transferee employer that the workers or a majority of them 'are part and parcel of the transaction.'[80] It concluded that there had been no prior agreement between UCT and the contractors that the workforce would be

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[76] 1999 (9) *BLLR* 875 (LAC).
[77] *NEHAWU v University of Cape Town and Others* 2000 (7) *BLLR* 803 (LC) at para 23
[78] Van Dijkhorst AJA wrote the judgment of the majority (with Comrie AJA concurring). Zondo JP dissented.
[79] *NEHAWU v University of Cape Town and Others* 2002 (4) *BLLR* 311 (LAC) at para 104.
[80] *ibid* at para 105.

transferred as part and parcel of the transaction, there was no transfer of a business as a going concern as contemplated in section 197(1)(a).

It went on to consider the decision in *Foodgro*. It held that the question whether contacts of employment are transferred automatically in the circumstances set out in section 197 had not been in issue in *Foodgro* and that the remarks of that court in this regard were *obiter*. It found that the decision in *Foodgro* did not prevent a finding that section 197(1) must be 'interpreted so as to limit its scope to cases where the transfer follows upon an agreement between the seller and the purchaser defining the subject matter of the sale as the business as a going concern (i.e. employees included)'.[81] In view of their conclusion on the law, the majority did not consider the facts. It accordingly dismissed the appeal and awarded costs both in the Labour Court and the LAC to UCT and Supercare.

The minority judgment reached a contrary result on the law and also found it unnecessary to consider the facts. It held that the purpose of section 197 was to protect the workers[82] and that the question whether a business has been transferred as a going concern is a matter of objective determination. Each transaction must be considered on its merits.[83] It concluded that the employer regardless of whether the two employers agreed that the workers would be transferred as part of the transaction.[84]

3.3. Constitutional Court pronouncements on the UCT Case

Against the backdrop of the above case in the Labour Court, and subsequently the Labour Appeal Court, the matter was referred to the Constitutional Court. An application was made for leave to appeal against the judgment and order of the LAC[85] dismissing an appeal by NEHAWU, the applicant, against the judgment and order of the LC.[86] The central question in this application concerns the meaning of section 197 of the LRA,

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[81] *NEHAWU v University of Cape Town and Others* 2002 (4) *BLLR* 311 (LAC) at para 117.
[82] *ibid* at para 68.
[83] *ibid* note 81 at para 65.
[84] *ibid* note 81 at para 94.
[85] *NEHAWU v University of Cape Town and Others* 2002 (4) *BLLR* 311 (LAC).
[86] *NEHAWU v University of Cape Town and Others* 2000 (7) *BLLR* 803 (LC).

1995. It is whether, in terms of section 197, upon transfer of a business as a going concern, the workers are transferred automatically with the business without a prior agreement to that effect between the transferor employer and transferee employer. Apart from this question, the application also raised important questions in relation to appeals from the LAC, namely whether such appeals lie to the SCA, the procedure to be followed in appeals from the LAC to the Constitutional Court and the circumstances in which this Court will hear such appeals.

On the jurisdiction, NEHAWU contended that the interpretation of section 197 of the LRA adopted by the majority of the LAC infringes on the rights of the workers to fair labour practices conferred by section 23(1) of the Constitution; that that is a constitutional issue. So too is the contention raised by NEHAWU that the interpretation of section 197 adopted by the majority of the LAC fails to promote the spirit, purport and objects of the Bill of Rights. Section 39(2) of the Constitution provides that

> '[w]hen interpreting any legislation...every court, tribunal or forum must promote the spirit, purport and object of the Bill of Rights.'

The LRA was enacted 'to give effect to and regulate the fundamental rights conferred by section 23 of the Constitution.'[87] In doing so the LRA gives content to section 23 of the Constitution and must therefore be construed and applied consistently with that purpose. Section 3(b) of the LRA underscores this by requiring that the provisions of the LRA must be interpreted 'in compliance with the Constitution'. Therefore the proper interpretation and application of the LRA will raise a constitutional issue.

However, UCT contended this approach and relied on the decision in *NAPTOSA and Others v Minister of Education, Western Cape and Others*[88] to point out that it was distinguishable from the present case. That case concerned the appropriateness or otherwise of granting relief directly under section 23(1) of the Constitution without a compliant that the LRA was constitutionally deficient in the remedy it provides. The court was concerned that granting relief directly under section 23(1) would encourage the

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[87] Section 1(a) of the LRA.
[88] 2001 (2) *SA* 112 (C).

development of two parallel streams of labour law jurisprudence, one under the LRA and the other under section 23(1). The court considered this to be 'singularly inappropriate'. It was in this context that the court remarked that it could not 'conceive that its is permissible for an applicant, save by attacking the constitutionality of the LRA, to go beyond the regulatory framework which it establishes.'[89]

However, the Constitutional Court opined that in its application, NEHAWU did not require the Court to go beyond the regulatory framework established by the LRA. The issues in the case were different from and nothing like those in NAPTOSA. Therefore, the dictum relied upon by UCT had no application in the case and the Court did not need to express any opinion on the correctness of that decision.[90] The Court therefore had the jurisdiction to hear this application.[91]

In consideration in this application was the purpose of section 197. *Ngcobo J* perceived that there was a divergence of opinion among the members of the LAC and the LC on the purpose of section 197. The one view, represented by the majority judgment of the LAC in this case is that its primary purpose is to facilitate the transfer of businesses.[92] The other view, represented by the minority judgment in the LAC in this case, maintains that the primary purpose of section 197 is the protection of workers in the event of the transfer of the business.[93]

According to *Ngcobo J* the answer lay somewhere in between. That an important purpose of section 197 was to protect the workers against the loss of employment in the event of a transfer of a business. That this conclusion is fortified not only by the effect of the section, but also by the very fact that the section was inserted in a chapter that deals

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[89] *supra* note 88 at 1231 – J.
[90] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] *ZACC* 27; 2003 (2) BCLR *154* at para 17.
[91] *ibid* as per Ngcobo J at para 18.
[92] *NEHAWU v UCT and Others* above note 72 per Mlambo J and *NEHAWU v UCT and Others* above note 71 per Van Dijkhorst AJA.
[93] Zondo JP in the case in the LC; Froneman DJP in the *Foodgro* case *supra* note 73 and Seady AJ in the *Schutte* case *supra* note 63.

with unfair dismissal. Further support of this view can be found in comparable foreign instruments and foreign case law construing these instruments.[94]

The foreign instruments in this case are those considered in the context of section 197, that is, the Acquired Rights Directive 77/187 EEC adopted by the European Commission in 1977 and the British Transfer of Undertakings (Protection of Employment) Regulation, 1981/1794 (TUPE) which was enacted pursuant to the Directive.[95] These 'provide some insight for proper interpretation and application of section 197'.[96]

Thus, section 197 relieves the employers and the workers some of the consequences that the common law visited on them. Its purpose is to protect the employment of the workers and to facilitate the sale of businesses as going concerns by enabling the new employer to take over the workers as well as other assets in certain circumstances. The section aims at minimizing the tension and the resultant labour disputes that often arise from the sale of businesses and impact negatively on economic development and labour peace. In this sense, section 197 has a dual purpose; it facilitates the commercial transactions while at the same time protecting the workers against unfair job losses.[97]

According to *Ngcobo J,* the meaning of section 197 as reasoned by the majority is based on the finding that in the context of this section the transfer of a business "as a going concern" only occurs where the workers are transferred as part of the transaction. According to the majority where the two employers agree to sell a business as a going concern, 'the necessary implication is that they agree that the employees or a material part thereof are part and parcel of the transaction.'[98] This finding forces the majority to conclude that section 197 must be interpreted 'so as to limit its scope to cases where the

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[94] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] *ZACC* 27; 2003 (2) BCLR *154* at para 46.
[95] *ibid* at para 47.
[96] *Foodgro* 1999 (9) *BLLR* 875 (LAC) at para 18
[97] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] *ZACC* 27; 2003 (2) BCLR *154* at para 53.
[98] *NEHAWU v University of Cape Town and Others* 2002 (4) *BLLR* 311 (LAC) at para 109.

transfer follows upon an agreement between the seller and the purchaser defining the subject matter of the sale as...a going concern (i.e. with the employees included).'[99]

According to *Ngcobo J,* there were two difficulties with this construction. The first to do with the meaning of transfer of business as a going concern and the second relates to the failure by the majority to take sufficient account of the fact that section 197 has the important purpose of protecting workers against loss of employment in the event of the transfer of business.[100]

Ngcobo J noted that the phrase "going concern" is not defined in the LRA, that it should be given its ordinary meaning unless the context indicates otherwise.[101] Thus, what is transferred must be a business in operation 'so that the business remains the same but in different hands.'[102]

The meaning assigned to the phrase "going concern" has not been suggested by the text of section 197. The fact that the seller and the purchaser of the business have not agreed on the transfer of the workforce as part of the transaction does not disqualify the transaction from being a transfer as a going concern within the meaning section 197. Each transaction must be considered on its own merit regard being had to the circumstances of the transaction in question. Only then can a determination be made as to whether the transaction constitutes the transfer of a business as a going concern.[103]

Further, the construction adopted by the majority does not take sufficient account of the important interest that workers have in job protection. The majority judgment in the LAC makes the application of section 197 conditional upon whether the two employers

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[99] *supra* note 98 at para 117.
[100] *supra* note 97 at para 55.
[101] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] *ZACC* 27; 2003 (2) BCLR *154* at para 56.
[102] *Lloyd v Brassey* [1969] 1 *All ER* 382 at 384H, a decision cited with approval by the House of Lords in *Melon and others v Hector Powe Ltd*[1981] 1 *All ER* 313 at 314c; *Manning v Metro Nissan – A Division of Venture Motor Holdings Ltd and another* (1998) 19 *ILJ* 1181 (LC) at para 42; See also *General Motors SA (Pty) Ltd v Bester Auto Component Manufacturing (Pty) Ltd and another* 1982 (2) *SA* 653 (SE) at 657H.
[103] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] *ZACC* 27; 2003 (2) BCLR *154* at para 58.

agree on whether the workers will be part and parcel of the transfer of business. This requirement offers the transferor and transferee some scope to structure their agreement so as to avoid the impact of section 197. They would be entitled but not obliged to make a provision for the transfer of workers as part of the transaction and the workers would be bound by that agreement.[104]

In essence this approach renders section 197 a voluntary obligation, in that if the new employer does not wish to take on the existing work force of the old employer on the existing terms and conditions then they will simply refrain from agreeing to take over the workers. Therefore, this majority decision potentially denied the workers protection against job losses.[105]

The true meaning of section 197 therefore lies in construing the section as a whole and in the light of its purpose and the context in which it appears in the LRA. Regard should also be had to the declared purpose of the LRA to promote economic development, social justice and labour peace. The section is found in a chapter that deals with unfair dismissals. With this in mind the interpretation of this section should make a provision for an exception to the principle that a contract of employment may not be transferred without the consent of the workers.

> 'Subsection (1) says so and it makes it possible to transfer the business on the basis that the workers will be part of that transfer. This will occur if the business is transferred "as a going concern".'[106]

The amendment to section 197 puts matters beyond doubt by providing that 'the new employer is automatically substituted in place of the old employer in respect of all contracts of employment'.[107] To verify this, its declared purpose is '...the clarification of the transfers of contracts of employment in the case of transfers of a business, trade or undertaking as a going concern'.[108]

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[104] *supra* note 103 at para 60.
[105] *National Education Health & Allied Workers' Union v University of Cape Town and Others* (CCT2/02) [2002] ZACC 27; 2003 (2) BCLR *154* at para 61.
[106] *Ngcobo J ibid* at para 62.
[107] Section 197(2) (a). *See* Annexure.
[108] See Preamble to the Amendment.

In conclusion *Ngcobo J* reiterated that upon transfer of a business as a going concern as contemplated in section 197(1) (a), workers are transferred to the new owner.

> 'The fact that there was no agreement to transfer the workforce or part of it between UCT and the contractors did not, as a matter of law, prevent a finding that the outsourcing was a transfer of a business as a going concern.'[109]

The Court decided, however, that the ambit of section 197 was a matter for the LAC to decide and referred the matter to it for determination.

3.4. Zikhethele Case

What is the impact of section 197 of the LRA on secondary transfers or second generation outsourcing arrangements?

Second generation contracting-out refers to the situation where a contractor performing an outsourced activity loses the contract which is then taken over by another contractor. The question arises whether there can be any talk of a section 197 transfer between the outgoing and incoming contractors.

These questions were pertinently considered in the recent matter of *COSAWU v Zikhethele Trade (Pty) Ltd.*[110] A hint of secondary transfers falling with the ambit of section 197 was seen in the decision of *SAMWU v Rand Airport Management Co (Pty) Ltd*[111]

In the Zikhethele case the court was confronted with rather interesting facts. Herein, the Fresh Produce Terminals (FPT) at the Cape Town, Port Elizabeth and Durban harbours outsourced the terminal and stevedoring services to outside companies which ultimately became Khulisa. The two main players in Khulisa were the managing director,

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[109] *Ngcobo J supra* note 103 at para 71.
[110] *COSAWU v Zikhethele (Pty) Ltd & another* [2005] (26) *ILJ* 1056 LC.
[111] SA Municipal Workers Union & others v Rand Airport Management Co (Pty) Ltd & others [2002] 23 *ILJ* 10561 J LC.

Mr Mfundisi and Mr Immelman the operations director. As a result of an acrimonious dispute between the two, FPT rethought its relationship with Khulisa. It put its terminal and stevedoring contracts out to tender and two new companies tendered for the business, namely, Zikhethele run by Mfundisi and a company formed by Immelman, trading as Signal Hill. FPT awarded the outsourcing contract to Zikhethele whereupon Signal Hill launched an urgent application in the High Court to interdict the implementation of the contract. In the interim COSAWU wrote a letter to Mfundisi to enquire whether the Khulisa employees were to be retrenched or whether they would transfer in terms of section 197 to Zikhethele. Mfundisi did not provide a candid response, partly; possibly, as a result of some Khulisa employees supporting Immelman's bid for the contract.

On the 1st of April 2005, the day when Zikhethele stepped into the shoes of Khulisa as FPT's service provider, Mfundisi as managing director of Zikhethele informed all Khulisa employees that they were seconded to Zikhethele from the 1st of April to the 11th of April. The purpose of the secondment seems to have been motivated by the fact that the application launched by Immelman's company to undo the outsourcing between FPT and Zikhethele would be heard on the 11th of April 2005. The matter was not heard and on 26th of April 2005, Mfundisi addressed a second memorandum to Khulisa employees informing them that their secondment would end on the 29th of April 2005. Khulisa employees were invited to apply for positions with Zikhethele if they wished to be employed by Zikhethele which indicated that there would be no automatic transfer of employment from Khulisa to Zikhethele. On 26th of April 2005, an application was made to place Khulisa under provisional liquidation, which order was granted on the 5th of May 2005.

As it was evident that only those employees of Khulisa who formally applied for positions with Zikhethele would be employed by the latter, COSAWU launched an application in the Labour Court to declare that all the rights and obligations between Khulisa and their employees not employed to Zikhethele transferred automatically in terms of section 197 of the LRA to Zikhethele when it won the contract to provide the terminal and stevedoring services of FPT.

The court first considered whether a second generation transfer fell within the ambit of the wording of section 197:

> 'Although the matter was not pertinently argued before me, a compelling argument can be made, based on the express language in section 197 of the LRA, that the requirement in s 197(1) (b) that a transfer of business be by one employer to another precludes its application to second generation contracting-out, because in such arrangements nothing is transferred from the old employer to the new one. Hence, second generation contracting-out is effectively exempted from the application of section 197.'[112]

While the court acknowledged that the express language of section 197 might specifically exclude a second generation transfer from its working, it was persuaded to conclude that:

> '...a less literal and more purposive approach is justified in the context of section 197. As stated earlier, the section is intended to protect the employees whose security of employment and rights are in jeopardy as a result of business transfers'.

The difficulty arising from second generation outsourcing and whether they fell within the ambit of section 197 was overcome by the court relying on the *Metsweding District Municipality* case[113] which held that the lack of a contractual link between transferor and transferee does not necessarily impede on the application of section 197 LRA.

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

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[112] [2005] 26 *ILJ* 10561 – J LC

[113] *Nokeng Tsa Taenane Local Municipality & Another v. Metsweding District Municipality & Others* [2003] 24 *ILJ* 2179 LC.

The court then turned to European law and practice to obtain guidance on how to deal with second generation transfers. The court considered the UK Court of Appeal decision in *Dines v Initial Services*[114] which constructs a second generation transfer as a two-phased process; the first being handing back of the service by the first contractor to the primary employer and the second phase being granting by the primary employer of the service to the second contractor.

Though the European courts do not rely on the concept of a going concern to bring transfers within their regulatory framework, the South African courts have relied heavily on what constitutes a transfer of a business in European law to interpret a transfer of a business as a going concern.

The court then turned to consider the facts and circumstances in the Zikhethele matter. The court was persuaded that there were significant features present to indicate that there was a transfer of a business as a going concern from Khulisa to Zikhethele. The court found the following factors as instructive in coming to its conclusion:

- The history of the outsourcing activities was as such that the service provided remained in almost identical form from the first outsourcing to the present.
- The same jobs had to be done
- The jobs were done from the same location.
- The jobs were done using the same operational methods.
- The same premises, fittings and equipment used by Khulisa were now at the disposal of Zikhethele.
- Some of the suppliers appeared to be the same.

From a policy point of view the court also concluded that a finding adverse to the applicants would render them unemployed, as Khulisa was in the process of being wound-up on account of it not being able to pay its debts, and also without their severance pay. The court echoed the European Law theme that in instances of transferring of business it is necessary to view the situation from an employment

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[114] [1994] *IRLR* 336

perspective and not from a perspective conditioned by principles of property, company or insolvency law.

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

In addition this decision has far-reaching consequences for potential new contractors when they are tendering to take over the business of another subcontractor as they would have to factor into their costing the potential transfer of the incumbent contractor's employee costs. Obtaining information of the existing contractor's employee costs will be difficult as it is unlikely that the existing contractor, considering it and the potential new contractor would be adversaries in any tender for the outsourcing business, would disclose such information. Some commentators argue that the sharing of employee costs, which would make up the bulk of the price model of a subcontractor, may attract the attention of the competition authorities established under the Competition Act 1998.[115]

> 'The concept of so-called "second generation contracting out" has been thrown yet another curve ball, as a new decision from the Labour Court indicates a conflicting perspective on this unsettling question.'[116]

The Labour Court in *AUSA v SAA*[117] has recently produced a new judgment which directly contradicts the decision in *COSAWU v Zikhethele Trade (Pty) Ltd & another [2005] 9 BLLR 924 (LC).* In Zikhethele, the court held that employees transferred to a subcontractor, when the original employer outsourced the work they performed, will be

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[115] PAK Le Roux *"Outsourcing and the transfer of employees to another employer"*. Contemporary Labour Law Vol. 14, No. 12, p.11.
[116] Jorge Araujo and Anna Posokhov, Webber Wentzel Bowens. *No Recognition for Second Generation Outsourcing,* 16 October 2007.
[117] *Aviation Union of South Africa and others v. South African Airways (Pty) Ltd and others* (Unreported case number J2206/07)

further transferred to a new subcontractor for as long as the original employer decides to outsource, and should the original employer choose to take back the work itself, the employees will return to his employ.

In *AUSA/SAA*, a contract with LGM through which SAA was outsourcing its non-core activities was prematurely cancelled, raising the question of what happened to the original SAA employees; should SAA continue to require the performance of said non-core services.

The court recognized that outsourcing may fall under the definition of the "transfer of a business...as a going concern" in terms of section 197, however, it followed a stricter approach in the application of section 197 in this particular case, stating that although the purpose of the section was to *protect* the interests of employees, the wording of the section should not be overstretched to include second generation outsourcing. The court touched on the popular view that since the section speaks of the transfer "by" one employer to another, it does not include second generation outsourcing, as in such cases, the contract is not transferred by the original employer, but by the first contractor. The court in *AUSA/SAA* criticized the court in *Zikhethele* for improvising in order to extend the application of this section to second generation outsourcing by substituting the word "by" with "from". This, the court held, was not the intention of the section, and that the court should leave this job to the legislature.

Thus the court in *AUSA/SAA* held that although the determination of whether a particular transaction will constitute a transfer of a business as a going concern, attracting the protection and consequences of section 197, the wording of the section should be strictly adhered to and thus the concept of second generation outsourcing is not contemplated in terms of this section.

The effect of the judgment is that should the first subcontractor lose the contract because the original employer chooses to "insource" the services or to appoint new contractor, the employees will remain with the first subcontractor. However it is worth

noting that since *Zikhethele* and *AUSA/SAA* were decisions of the Labour Court, the final word may yet remain to be spoken by a higher court.

4. Outsourcing and Business Reorganization

Outsourcing is an important part of business restructuring in South Africa and indeed globally. It has been defined as '[t]he policy of hiring outside consultants, trainers, technicians and other professionals to take over the complete function of a particular department (e.g. human resources) of an enterprise, rather than employing full-time personnel. This often involves non-core activities such as catering, communications and data processing.'[118]

Outsourcing is the activity employers engage in to discontinue non-core activities or services and to engage independent contractors to perform such services. Employers therefore engage in outsourcing to free themselves off managing non-core activities on one hand and also to reduce the costs associated with such activities on the other hand.

Outsourcing is a business trend which has enjoyed increasing popularity in Europe and the US over the past few years and the recent growth of outsourcing companies in South Africa is a strong indication that this trend is being mirrored in the South African economy.

A debate exists in the South African Employment Law as to whether outsourcing constitutes a transfer of the company's business and hence whether, barring a retrenchment exercise, employment contracts are automatically transferred to the outsourcing company. The legal enquiry herein being, whether outsourcing is the sale or merely the outsourcing of a function. The labour courts have expressed varying views.

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[118] Barker and Holtzhauzen *South African Labour Glossary* (Juta, 1997).

An interesting Labour Court decision, that has been discussed herein, involved *NEHAWU and the University of Cape Town*,[119] in which an outsourcing exercise (gardening and cleaning services) was challenged. As seen, the court held that the outsourcing did not constitute a transfer of a part of the university's business and, accordingly, the employment contracts would not automatically be transferred to the outsourcing company. The University was vindicated in its retrenchment.

The Labour Appeal Court also ruled that the contracts of employment did not qualify automatically for a transaction covered by section 197. But the Constitutional Court, in a further appeal, ruled that section 197 did have the effect that contracts of employment were transferred automatically, as the intention of the clause was to protect workers from retrenchment when a business was transferred.

The amendments to Section 197 of the Labour Relations Act were intended to settle the controversy that has raged since the introduction of the Labour Relations Act 1995 as to the obligations of the old and new employer when the whole or part of a business is transferred from the old employer to the new employer.[120]

As stated in an earlier chapter, employees are protected where the whole or part of a business, trade, undertaking or service is transferred as a going concern. Section 197 and 197(A) of the LRA provide that whenever an undertaking or part of an undertaking is sold as a going concern, the new employer is automatically substituted in the place of the old one. All employment rights and obligations pass over automatically to the new employer, unless otherwise agreed. Furthermore, anything done before the transfer by, or in relation to the old employer including any dismissal, commission of any unfair labour practice or act of unfair discrimination is considered to have been done by, or in relation to, the new employer. It should be noted, however, that criminal liability does not transfer

[119] 2000 (7) *BLLR* 803 (LC).
[120] St. Elmo Wilken, *Sweeping changes to transfers of business.*

and remains with the perpetrator, namely the old employer. The primary intent of this provision is to ensure employment security and job continuity.[121]

Thus, on every occasion when a part of an undertaking is transferred as a going concern, employers are obliged to comply with Section 197 or 197(A) and employees are entitled to protection under these sections. It is therefore of no consequence whether the transfer of the business, whether in part or as a whole, is effected by a series of transactions or not.[122]

As previously stated, courts will look at all the factors objectively – the intentions of the parties will not be determinative. The courts will look at the substance rather than the form of the transaction. Thus, if an outsourcing agreement is implemented which the court determines falls within the ambit of section 197 then the contracts of employment of all those employees who previously performed the functions which are outsourced will transfer to the service provider on the prevailing terms and conditions.

In circumstances where assets alone are transferred and the business is not continued, protection under section 197 and 197(A) does not apply. Section 197 of the LRA deals with those circumstances where the undertaking being transferred is solvent. Section 197(A) deals with those circumstances where the undertaking being transferred is insolvent.

As explained earlier, The South African courts have relied heavily on European Court authority in grappling with the interpretation of the term "going concern". A transaction whereby the undertaking is actually continued or resumed by the employer with the same or similar activities as the old employer will constitute a transfer as a going concern.

With the foregoing, it therefore becomes imperative for a potential service provider to consider the cost effectiveness of transaction in that if the service provider has to take on

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[121] *supra* note 120.
[122] *supra* note 120.

the previous employer's employees on the same terms and conditions, this would have serious implications on the service provider.

It maybe necessary to negotiate with and effectively "buy" employees' agreement to terminate or agree to lesser terms and conditions in section 197 situations.

Business restructuring is constantly being engaged in by employers seeking to ensure that their businesses remain competitive in a harsh commercial environment. However, employers engaged in restructuring, be it in the form of outsourcing or introducing new organizational templates, are restrained by employees' rights, by the requirement that they treat their employees fairly.[123] Employers must therefore be aware of the relevant provisions and how they impact on particular restructuring processes. Employees must be aware of their entitlements in terms of the LRA.[124]

5. Problems Relating To Section 197.

5.1. Problems with the wording of section 197 LRA (1995)

Section 197 of the LRA attracted criticism because of its unclear text, it led to numerous uncertainties about its wording and legal effect. *Blackie* and *Horwitz*[125] evaluated the situation after the enactment of section 197. They pointed out practitioners were confronted with several difficulties because of its wording.

5.1.1. "Transfer"

The first problem was posed by the title of section 197 of the LRA. Regarding the phrase "transfer of undertaking", one had to make clear what the term *transfer* meant, in other words what constituted a transfer and when it came into effect. It was questionable whether and under which circumstances a share sale or asset deal would fall under section 197 of the LRA.

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[123] These are contained, *inter alia*, in sections 197, 197A, 188, 189 and 189A of the Labour Relations Act 66 of 1995 and as amended in 2002.
[124] Craig Bosch, *Business restructuring: some important labour law issues.*
[125] Blackie W & Horwitz F, *Transfer of contract of employment as a result of mergers and acquisitions* (1999) *ILJ* 1387, 1394.

The European approach on the definition of the definition of this term has generally been left to the courts. The question of when the Acquired Rights Directive would be applicable has to be answered by applying a two-stage test. The first step was the position prior to the transfer. The court had to determine the question whether there was an identifiable economic entity carried on by the transferor. The second stage was to answer the question whether this economic entity maintained its identity.

The first leading decision of the European Court of Justice was the decision in *Josef Maria Antonius Spijkers v Gebroeders Benedik Abattoir CV et Alfred Benedik en Zonen BV.*[126] The European Court of Justice argued that,

'...it is clear that the term 'transfer' implies that the transferee actually carries on the activities of the transferor as part of the same business".

11 That view [of the Netherlands' government] must be accepted. It is clear from the scheme of Directive No. 77/187 and from the terms of article 1(1) thereof that the directive is intended to ensure the continuity of employment relationships existing within a business, irrespective of any change of ownership. It follows that the decisive criterion for establishing whether there is a transfer for the purpose of the directive is whether the business in question retains its identity.

12 Consequently, a transfer of undertaking, business or part of a business does not occur merely because its assets are disposed off. Instead its necessary to consider, in a case such as the present, whether the business was disposed off as a going concern, as would be indicated, inter alia, by the fact that its operation was actually continued or resumed by the new employer, with the same or similar activities.

13 In order to consider whether those conditions are met, it is necessary to consider all the facts characterizing the transaction in question, including the type of undertaking or business, whether or not the business's tangible assets, such as buildings and movable property, are transferred, the value of its intangible assets at the time of transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred and the degree of similarity between the activities carried on before and after the transfer and the period, if any, for which those activities

[126] (ECJ) in *ECR* 1986, 1119 ff..

were suspended. It should be noted, however, that all those circumstances are merely single factors in the overall assessment which must be made and cannot therefore be considered in isolation.'[127]

According to *Van Niekerk*, it is in South Africa and elsewhere "generally accepted" that a transfer in the sense of section 197 LRA does not include the acquisition of control caused by the transfer of shares.[128] The problem with this view is that there could in fact be a change of the persons who control the business because of their number of shares. Should new persons control the undertaking, these persons will have a great influence on the relationship between employee and employer, although the employer remains *de jure* the same person as prior to the transfer of shares. Because section 197 is not applicable to the transfer of shares, the employee is not allowed to terminate his contract, if the control of the business he is working for has changed.[129]

If one would accept the person who controls the work as the practical employer, one has to assume that the exclusion of transfer from the applicability of section 197 of the LRA could be a departure of the common law rule that an employee has a right to choose his employer. But the employee, of course, has the possibility to resign from working for the company. It is not necessary that the employer has to consult the representatives of the employees in this regard. The sale of the controlling shareholding is the most common method of transfer of the control of companies.[130] It is certainly not the most advantageous possibility to exclude this method from the scope of section 197 LRA.

5.1.2. "Going Concern"

For the transfer of the employment contract by act of law as described in s. 197(1) (a) of the LRA it is essential that the transfer occur as a "going concern". Neither the LRA nor the common law provided any definition for the term "going concern". The South African courts examined this term and compared it with legal sources abroad. This happened, for instance in the Cape High Court's decision of *General Motors SA (Pty)*

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[127] (ECJ) in *ECR* 1986, 1119ff. at para 10-13.
[128] Van Niekerk A, *Unfair Dismissal*, 87.
[129] *ibid*; Smit N, *Labour Law implications of the transfer of an undertaking*, 119.
[130] Smit N, *Labour Law implications of the transfer of an undertaking*, 119.

Ltd v Besta Auto Component Manufacturing (Pty) Ltd & another,[131] where the court examined the Australian decision to *Ferne v Wilson.* Within this decision of 1900 the "going concern" was described as follows:

> ' The words "as a going concern" are merely intended to mean that the shop is being kept open instead of being closed up, and that the customers are being kept together so that if the purchaser wishes to keep on the business he can do so;....'[132]

According to the South African jurisdiction, a sale of only the assets of a business is not a transfer of this business, and certainly not a transfer as a going concern.[133] *Van Niekerk* added that a transfer of assets cannot be considered a transfer as a going concern.

One of the most widely discussed problems in South Africa as well as European labour law is the notion of the term *going concern.* This term was not utilized by the Labour Courts under the Labour Relations Act (1956).[134] There was no necessity to do so, because of the impossibility of applying a statutory provision which would protect employment in the event of a transfer of a business or part thereof.

Despite the fact and knowledge of the legislature that the notion of a going concern was problematic as discussed herein, the Labour Relations Act of 1995 contains no definition of this term.

In the important case of *Schutte & others v Powerplus Performance (Pty) Ltd*[135], the Labour Court argued that there was indeed a transfer of business as a going concern. The Labour Court used the term "economic entity" which has to be transferred as a going concern. But the court did not use the test developed by the European Court of Justice (ECJ) for the transfer of a going concern, which considers the transfer of an economic entity retaining its identity within that decision. The term "going concern" refers, as

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[131] (C) in 1982 2 SA 653ff..
[132] *General Motors SA (Pty) Ltd v Betsa Auto Component Manufacturing (Pty) Ltd & another* (C) in 1982 2 *SA* 653,657 in reference to *Ferne v Wilson* in 1900 26 VLR 422 at 437
[133] Van Niekerk A, *Unfair Dismissal,* 88.
[134] Smit N, *Labour Law implications of the transfer of an undertaking,* 175.
[135] (LC) in *ILJ* 1999, 655ff..

mentioned above, to a business in operation. Regarding insolvent businesses, one had to recognize that these establishments are often not in operation any longer. The above-discussed terms of section 197 of the LRA were in this respect too vague.

5.1.3. "Rights and Obligations

S. 197 (2) (a) of the LRA (1995) stated that all 'the rights and obligations between the old employer and the new employer [will] continue.' But the regulation left unclear which obligations and rights were relevant and had to be transferred. It was questionable whether only agreements between transferor and employee could be subsumed under this term, or whether it also contains special rights and obligations between the transferor and a third person.

Section 197 of the LRA (1995) distinguished between the transfer of a solvent business in subsections [(1) (a), (2) (a)] and the transfer of insolvency or a rescue of an undertaking in subsections [(1) (b), (2) (b)]. The biggest difference between these two mechanisms was that subsection (2) (b) of the LRA (1995) provided that

'...all rights and obligations between the old employer and each employee at the time of the transfer remain rights and obligations between the old employer and each employee, and anything done before the transfer by the old employer in respect of each employee will be considered to have been done by the old employer'.

Jones stated that the legislator had good reason for this wording, because a business without any obligation to its employees would be much more attractive to prospective buyers.[136] But according to *Wallis*, the rights and obligations between the employee and the old employer were transferred, if they formed part of the contract of employment, whereas the restriction from section 197 (2) (b) of the LRA (1995) covers only rights and obligations with third parties.[137]

It was also unclear whether section 197 of the LRA (1995) also covered rights and obligations, which were not covered by the relationship between old employer and

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[136] Jones J, *The Interpretation and effect of section 197 of the Labour Relations Act 66 of 1995,* 84.
[137] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 7.

employee but arose from other contracts, delicts or statutes. The Act itself was in this regard silent. Because of the main issue to regulate labour relations, it seemed to be clear that only these rights and obligations were transferable, which formed part of the relationship between transferor and employee.

5.1.4. General criticism of LRA (1995)

At a first glance the Act brought much more security to the employees in cases of the transfer of undertakings, businesses or parts thereof. The great advantage was the possibility of an automatic transfer of the contracts of employment in cases of a transfer of a going concern by the act of law.

In this regard one has to bear in mind that the protection of existing jobs could have in general a negative effect for the political aim to create more jobs. Greater protection for the workforce of an undertaking, which is involved in a transfer of its business, could lead to fewer possibilities for the political and social aims to create jobs.

5.2. Problems with the wordings of the new regulations

One major problem under section 197 of the LRA (1995) was the unclear wording of this regulation. These uncertainties had a negative effect for the parties concerned in the transfer. According to *Le Roux*, section 197 of the LRA (1995) was far from clear in its scope and potential effect.[138] Even the Minister of Labour said,

> '...that it is important to provide certainty to employers and employees as to their rights and obligations in such circumstances'.[139]

The Minister makes it clear that the legislation had acknowledged the criticism of the unclear wording and uncertainties of section 197 of the LRA (1995).

5.2.1. The scopes of Section 197A (1) (a) and (b) of the LRA (2002)

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[138] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 61.
[139] http://www.info.gov.za/speeches/2000/000727110p1004.htm; visited on 26/09/2007.

If one compares s. 197 (1) (b) of the LRA (1995) with s. 197A (1) of the LRA[140] that regulates the transfer of employment contracts in insolvent circumstances, some changes to the text are evident. S.197 (1) (a) (i) of the LRA (1995) provided:

'...if the old employer is insolvent and being wound-up or is being sequestered...'

The amended s. 197A (1) (a) of the LRA provided for the transfer

'...if the older employer is insolvent;....'

The first regulation led to several uncertainties. S. 197 (1) (b) (i) of the LRA (1995) referred to the old employer that 'is insolvent and being wound-up'. The reference to the employer being wound-up seems to be a reference to a company or a close corporation that is unable to pay its debts.

However, section 344 of the Companies Act does not refer to a company being insolvent and, unusual as it may seem, there are situations where a perfectly solvent corporate bodies are wound-up either voluntarily or by order of the court. The desire to use plain English in section 197 of the LRA merely caused confusion.[141]

With the new text the legislature tried to resolve the uncertainties of the old regulation, while using an all-comprehensive term to bring all above-mentioned possibilities of being insolvent under the scope of the LRA. The broader wording 'is insolvent' could resolve the former uncertainties.

The text of section 197 (1) (b) (ii) of the LRA (1995) remained unchanged in the new section 197A (1) (b) of the LRA and refers to the transfer of business.

'[i]f a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency.'

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[140] Due to its length, the text of sections 197 and 197A Labour Relations Acts (1995& 2002) will be found *infra* at the Annexure. – Following sections of the LRA without the annexed year 1956 or 1995 refer always to the versions of 2002.

[141] Wallis MJD, Section 197 is the Medium. What is the message? (2000) *ILJ* 1, 6.

A new problem with the wording of section 197A (1) (b) of the LRA comes from the passage, '*to avoid* winding-up or sequestration for reasons of insolvency'[142]. The question arises whether such a scheme will be limited to the period prior to the effective date.[143] A liberal interpretation could come to the conclusion that also the period after the effective date would be contained by s. 197A (1) (b) of the LRA.[144] However, the wording of this paragraph does not lead to a clear answer to that question. In this regard, one has to keep in mind that the effective date is surely not the end of any rescue procedures. Trustees often facilitate such schemes of arrangements and compromises after the effective date. It would not be appropriate to exclude such schemes from the scope of section 197A of the LRA. The protection of employees should not depend on the effective date.

Remarkable enough, such schemes often lead to a share of sales. Nevertheless, sections 197ff..of the LRA exclude such transfers from its application as stated *supra*. *Zondo J* pointed out that there is a 'crying need' to amend section 197 of the LRA (1995) in order to extend the protection of employees where shares are transferred.[145] But s. 197A (1) (b) of the LRA did not resolve the problems with share deals.

5.2.2. "Services"

The LRA (1995) only included the matters of transfers of the whole or part of a business, trade or undertaking and thus excluded several outsourcing operations from its scope. With respect to the outsourcing of non-core activities, one could argue that these activities are neither a whole nor parts of a business, trade or undertaking.[146] For instance, in the decision to *SAMWU & others v Rand Airport Management Co. (Pty) Ltd & others*[147] the LC rejected that garden services could be viewed as part of a business.

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[142] Italics added.
[143] The "effective date" is broadly spoken of as the date of the provisional sequestration order in the case of compulsory sequestration and the date of the sequestration order in the case of voluntary surrender.
[144] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1864.
[145] *Ndima* (LC) in *ILJ* 1999, 1563, 1579.
[146] The question whether contracting out, with respect of outsourcing, could be applied under section 197 LRA (1995) was the crux of the decision to *NEHAWU vUCT* of LC, LAC, and CC.
[147] (LC) in *ILJ* 2002, 306 ff..

The amended section 197(1) (a) of the LRA (2002) now reads

'..."business" includes the whole or part of any business, trade, undertaking or *service*'[148]

It is debatable whether outsourcing activities will fall under section 197 of the LRA (2002) and thus lead to the transfer of employment contracts. Employers typically use outsourcing models to divest themselves of non-core activities and to save labour costs. If section 197 would be applicable in such outsourcing, these costs will simply be passed on to another party. Outsourcing will lose its position as a business alternative and employers could increasingly resort to temporary or part-time labour, or even closures. Section 197 would fail to reach an advantageous effect for employees.[149]

Although it is not sure that the legislation had intention to do so,[150] an expression of the text of section 197 of the LRA with the term *service* could offer a possibility to typify outsourcing activities as going concern transfers. It is furthermore questionable whether the implication of the term "service" successfully changed the scope of section 197 of the LRA.[151]

In *NUMSA v Staman Automatic CC & another*[152] *Landman J* held,

'The amendment to section 197 has not changed the general purpose of this section. It is aimed rather at clarification.'[153]

Even under section 197 of the LRA (1995) the Labour Court was prepared to hold that an outsourcing transaction constitutes a transfer in term of section 197. In *NEHAWU*[154], *Mlambo J* stated,

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[148] The amendment was prompted by an initiative of COSATU.
[149] Van Niekerk A, *Presentation outline: Outsourcing and transfer of undertakings* (Labour Law Conference 2003).
[150] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 64.
[151] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.
[152] (LC) in *BLLR* 2003 1167ff..
[153] (LC) in *BLLR* 1167,1172
[154] (LC) in *ILJ* 2000, 1618 ff..

'In this regard it is possible that some outsourcing exercise could be of a permanent nature, and this type could amount a transfer of a business.'[155]

The LRA does not define the term "service". For the definition of the term "business" the term "service" will not be helpful at all, because the reference to "service" will lead to new uncertainties.

Zondo JP stated in *SAMWU v Rand Airport Management Company (Pty) Ltd.,*[156]
'Section 197 was amended pursuant to Act 12 of 2002. Of particular relevance to the present dispute is the amendment, which introduced the concept of "service" in the definition of "business" and, hence of transfer as contained in section 197(1) of the Act. ...Although not defined in the Act, the common meaning of "service" as set out in the new Shorter Oxford English Dictionary is 'The provision of a facility to meet the needs or for 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; an instance of beneficial, useful or friendly actions; the action of serving, helping or benefiting another; behaviour conducive to the welfare or advantage of another; friendly or professional assistance.''[157]

However, the extension by the term "services" does not lead to the point that outsourcing activities could be considered as transfers of businesses as going concerns.[158] The critical point concerning an outsourcing activity is not only whether the outsourced object would be a business, but primarily whether the transfer occurred as a *going concern.*

5.2.3. "As a going concern"

The concept of a business as a going concern has been the subject of debate since its introduction, as already considered *supra.* Only in a few cases have South African courts decided about the meaning and scope of the concept of transfer as a "going concern". But in this regard it is necessary to mention that it is often hardly possible for the courts to decide which fact one has to subsume under which terms of section 197. In transfer matters the terms "services", "transfer" and most specifically "going concern" often have

[155] (LC) in *ILJ* 2000, 1618, 1632.
[156] (LC) in *ILJ* 2002, 306ff..
[157] (LC) in *ILJ* 2002, 306 ff. Zondo, para. 17.
[158] Le Roux PAK, Consequences arising out of the sale or transfer of a business (2002) *CLL* 61, 64.

to be proved by the same facts. Because of the facts that South African courts often referred to the jurisdiction of the ECJ with respect to the tests of applicability of the statutory provisions, the struggle of the ECJ to deal with the term "going concern" shall be examined in detail.

One of the most discussed problems is the concept of transfers "of an economic entity that retains its identity" in the decision of *J.M.A. Spijker v Gebroeders Benedik Abbatoir CV and Alfred Benedik en Zonen BV*[159] the European Court of Justice followed the arguments of the United Kingdom Government and the European Commission. They said that in this respect the essential criterion is whether the transferee is put in possession of "a going concern" and is able to continue its activities.[160] The European concept thus raises the same question as the concept of a transfer "as a going concern".

It is thus questionable under what circumstances an economic entity retains its identity. In its well-known *Christel Schmidt* decision[161], the European Court of Justice argued that there might be a relevant transfer in the sense of the ARD, even though only one employee is affected. The Labour Court of the second instance asked the ECJ to make preliminary ruling based on the following two questions:

> '1.) Could an undertaking's cleaning operations, if they are transferred by contract to a different firm, be treated as part of a business within the meaning of Directive 77/187/EEC?
> 2.) If the answer to Question 1 is in principle in the affirmative, does that also apply if prior to the transfer the cleaning operations were performed by a single employer?'

According to the German government, the concept of an economic entity used in the jurisprudence of the ECJ is used to summarise the three concepts of an undertaking, business or part of a business within the meaning of the ARD; the concept implies that a defined economic objective is pursued in the context of an autonomous organization that may be part of a larger one. The German government suggested that the ECJ would treat the undertaking's cleaning operation in these matters as part of a business in the sense of

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[159] (ECJ) No. 24/85. *IELL*, Case Law, No. 88.
[160] Blanpain R & Engels C, *European Labour Law*, para. 507.
[161] *Schmidt v Spar-und Leihkasse der Früheren Ämter Bordesholm, Kiel und Cronshagen* (ECJ) in *ECR*, 1994, 1311ff.

the ARD. The government of the United Kingdom stated that the fact that an undertaking ceases an activity, such as the cleaning of its own premises, and instead pays another undertaking to provide that service, does not in itself constitute a transfer of an undertaking, business or part of a business. The ECJ reflected the basic principles behind ARD,

> 'Article 1(1) of the Council Directive 77/187 on the approximation of the laws of the Member States relating to safeguarding of employees' rights in the event of transfers of undertakings, business or parts of businesses is to be interpreted as covering a situation in which an undertaking entrusts by contract to another undertaking the responsibility for carrying out cleaning operations which it previously performed itself, even though, prior to the transfer, such work was carried out by a single employee.'[162]

Regarding the problem of the transfer of an economic entity, the ECJ stated as follows,

> ' Neither the fact that such a transfer relates only to an ancillary activity of the transferor not necessarily connected with its objects, nor the fact that it is not accompanied by any transfer of tangible assets, nor the number of employees concerned is capable of exempting such an operation from the scope of the directive since the decisive criterion for establishing whether there is a transfer for the purpose of that directive is whether the business in question retains its identity, as indicated in particular by actual continuation or resumption by the new employer of the same or similar activities.'
>
> According to the case-law of the Court (judgment in Case C-209/91 *Watson Rask and Christensen v ISS Kantineservice* [1992] *ECR* I-5755, at paragraph 15), the directive is applicable where, following a legal transfer or merger, there is a change in the legal or natural person who is responsible for carrying on the business and who by virtue of that fact incurs the obligations of an employer vis-à-vis the employees of the undertaking, regardless of whether or not ownership of the undertaking is transferred.
>
> The decisive criterion for establishing, whether there is a transfer for the purpose of the directive is whether the business in question retains its identity. According to the case-law, the retention of that identity is indicated *inter alia* by the actual continuation or resumption by the new employer of the same or similar activities. Thus, in this case ...the similarity in the cleaning work performed before and after the transfer, which is reflected, moreover, in the offer to re-engage the employee in question, is typical of an operation which comes within the scope of the directive and which gives the employee whose activity has been transferred the protection afforded to him by that directive.'[163]

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[162] At para. 20.
[163] At para. 17.

Rejecting its former opinion, the ECJ pointed out that

> '[t]he mere loss of a service contract to a competitor cannot therefore by itself indicate the existence of a transfer within the meaning of the directive. In those circumstances, the service undertaking previously entrusted with the contract does not, on losing a customer, thereby cease to fully exist, and a business or part of a business belonging to it cannot be considered to have been transferred to the new awardee of the contract.'[164]

To answer the question whether the economic entity was transferred under the maintenance of its identity, one has to consider a whole package of factors. The ECJ stated in this respect,

> 'In order to determine whether the conditions for the transfer of an entity are met, it is necessary to consider all the facts characterizing the transaction in question, including in particular the type of undertaking or business, whether or not its tangible assets, such as buildings and moveable property, are transferred, the value of its intangible assets at the time of the transfer, whether or not the majority of its employees are taken over by the new employer, whether or not its customers are transferred, the degree of similarity between the activities carried on before and after the transfer, and the period, if any, for which those activities were suspended. However, all those circumstances are merely single factors in the overall assessment, which must be made and cannot therefore be considered in isolation.'[165]

In the decision of *Carlito Abler v Sodexho MM Catering Gesellschaft,*[166] the *Christel Schmidt* decision found its successor.[167] The facts of the case can be sketched as follows. In November 1990 an orthopaedic hospital contracted out its catering services to a company called Sanrest. It prepared and served meals, using equipment and premises provided by the hospital. Several years later the contract was transferred to Sodexho, following a re-tender, on the same basis as Sanrest. Sanrest argued that this constituted a transfer of an undertaking, even though Sodexho had refused to take on any of the employees and did not inherit any of their stocks and materials.

The ECJ considered catering as an activity that does not rely essentially on manpower, as it requires a lot of equipment. It stated that there was a transfer of a

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[164] At para. 16.
[165] At para. 14.
[166] (ECJ) in Rs. C. 340/01; in *NZA* 2003, 1385 ff..
[167] Junker called it a "Wierdergänger" in Junker A, *Europäisches Arbeitsrecht* 2003, 8.

business as a going concern, though one could argue that the hospital only changed its supplier of catering. The ECJ argued in its preliminary ruling that the catering company Sodexho, as a new contractor and transferee of the business, had to take on the liability for the employees, because it carried out the same services and used a substantial part of the assets used by the first contractor and transferor.

Certainly it would be a great advantage if the South African courts could incorporate the experiences of the ECJ. However, it is instructive to note that the exact meaning of "going concern" is case sensitive. Every new case will be a new struggle to evaluate the facts properly and to balance the respective interests.

The LAC held in the decision to *NEHAWU v UCT*[168] that the

'[l]ack of emphasis thereon or a misunderstanding thereof leads to misinterpretation of the section.'[169]

Despite the small number of decisions, they were not consistent. According to *Boraine* and *van Eck*, there was still a 'pressing need' for the clarification of the term "going concern" after the implementation of section 197 of the LRA, especially where the transfer occurred in insolvent circumstances.[170]

It is questionable whether sections 197 and 197A of the LRA will be applicable at the discontinuation of business operations as a result of sequestration or liquidation, if all assets of the insolvent employer will be sold to a single buyer and this buyer takes over some but not all of the old employees.[171]

The Constitutional Court stated in its landmark decision to *NEHAWU v UCT,*[172]

'The phrase "going concern" is not defined in the LRA. It must therefore be given ordinary meaning unless the context indicates otherwise. What is transferred must be a business in operation so that the

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[168] (LAC) in *ILJ* 2002, 306 ff..
[169] *ibid* at para. 10.
[170] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.
[171] See example by Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.
[172] (CC) in *ILJ* 2003, 95 ff..

business remains the same but in different hands. Whether that has occurred is a matter of fact, which must be determined objectively in the light of the circumstances of each transaction. 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.'[173]

The Constitutional Court reached this decision in respect of a solvent business. It is doubtful whether this approach would be changed in insolvent circumstances. Although the circumstances are different, it is rather unusual that there are two different definitions of the same term. However, even after the Constitutional Court's decision, the meaning of the concept of transfer as a going concern under insolvent circumstances remains unclear. It is questionable whether the sale of a business as a going concern takes place when it is transferred after its discontinuance.

However, according to *Boraine* and *van Eck*, there was a 'golden opportunity' to resolve these uncertainties.[174] Section 197(2) (a) of the 2000 Draft of the Amendment to the LRA contained a clarification and regulated what kind of "transfer of a business" would be covered by section 197 of the LRA. This subsection did not define the meaning of a "transfer of a business" per se, but the concept of a business "as a going concern". It provided the subsection as follows,

'(2) A transfer of a business is covered by this section, if –

(d) an economic entity, consisting of an organized grouping of resources, that has an object of performing an economic activity is transferred; and

(e) the economic entity retains its identity after the transfer.'

Despite possible advantages to defining this crucial term, the 2001 Draft of the Labour Relations Bill no longer contained that definition. The result of that regulation, i.e. the lack of a clear definition, could be seen as a pity.[175] However, the decisions of the ECJ show problems of definition abundantly clearly, as could be seen *supra*.

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[173] *supra* note 172 at paragraph 56.

[174] Boraine A & Van Eck S, The New Insolvency and Labour Legislative Package: How successful was the Integration (2003) *ILJ* 1840, 1855.

[175] Smit N, *Labour Law implications of the transfer of undertaking,* 427.

The Labour Appeal Court emphasized in *NEHAWU v UCT*[176] the importance of the workforce in the consideration of the "going concern" when it held,

> '[a] business is a going concern only if its assets, movable and immovable, tangible and intangible, are utilized in the production of profit (or in the case of undertakings, in the attainment of goals). In every business its employees are a vital component and in labour intensive industries the major asset. To say there can be a sale of a business as a going concern without all or most of the employees going over is to equate a bleached skeleton with a vibrant horse.'[177]

Van Niekerk cites that there are several indicators which show that a transfer of an economic entity that retains its identity had taken place, e.g.

> '[t]he type of the undertaking, business, trade or services;
> the fact that its operation was actually continued or resumed by the new employer, with the same or similar activity;
> whether or not tangible assets, such as buildings and moveable property, are transferred;
> the value of its tangible assets at the time of the transfer and whether they are transferred;
> whether the majority of its employees are taken over by the new employer;
> whether its customers are transferred;
> the degree of similarity between the activities carried on before and after the transfer;
> the period, if any, for which those activities were suspected.'[178]

These criteria are in fact the outcome of the jurisprudence of the ECJ. The ARD does not define "going concern" either. It is conceivable that the long-established case law of the ECJ will be of considerable assistance to South African jurisprudence.

However, one has to keep in mind that the European jurisdiction is still challenging and tries to reach certainty on the issue. Although the South African courts have drawn extensively from European jurisdiction,[179] it is doubtful if South African courts could profit from European precedents of the last three decades.[180] Because of the lack of legal

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[176] (LAC) in *ILJ* 2002, 306 ff..
[177] *ibid* at para. 10.
[178] An examination of such a basket of indicators by Landman J can be found in *SAMWU & others v Rand Airport Management Co* (LC) in *BLLR* 2002, 1219 ff.
[179] e.g. in *Foodgro v Keil, Ndima v Waverly Blankets Ltd* and *Schutte v Powerplus.*
[180] Smit N, *Labour Law implications of the transfer of undertaking,* 427.

definition South African courts will continue to interpret the meaning of the term "going concern".

Section 197 has been held to be applicable to the first phase of contracting out, and by a major opinion to second-generation contracting out and contracting back, i.e. the reversion in-house of a service previously contracted out as well.[181] It was in question whether the second-generation contracting out (also termed as second-generation transfer)[182] could be covered under section 197 of the LRA. In the decision of *COSAWU v Zikhethele Trade (Pty) Ltd & another*[183] the Labour Court held in respect to the clear wording as follows:

'Although the matter was not pertinently argued before me, a compelling argument can be made, based on the express language in Section 197 of the LRA, that the requirement in s. 197(1) (b) that a transfer of business be by one employer to another precludes its application to second-generation contracting out, because in such arrangements nothing is transferred from the old employer to the new employer. Hence, second-generation contracting out is effectively exempted from the application of s. 197.'[184]

The court referred to the term "by" and concluded correctly that nothing was transferred *by* the old employer. The logic that would arise from reading the text of section 197 (1) (a) LRA (2002) 'the whole or any part of the business is transferred by *or from* the old employer as a going concern' is to reject that there was a transfer from the old employer.[185] It is rightly the courts' task to interpret the Acts, 'but this interpretation finds its end at the clear text of a section'[186] as stated above. However, one can read section 197 LRA (2002) in conformity with the Constitution. Herein, the Labour Courts referred to the European regulation and jurisdiction, wherein it was stated that in situations of the transfer of a business, there is a necessity to consider the situation from

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[181] Van Niekerk A, *Presentation outline: Outsourcing and transfer of undertakings* (Labour Law Conference 2003).
[182] Second-generation contracting out refers to a situation where a contractor performing an outsourced activity loses the contract which is then taken over by another contractor, - Bosch C. *Business restructuring; some important labour law issues.*
[183] (LC) in *ILJ* 2005, 1056ff..
[184] (LC) in *ILJ* 2005, 1056, 1056.
[185] See Todd C *et al, Business Transfers and Employment Rights in South Africa,* 28 at footnote 54.
[186] Wolfgang Spree, *The transfer of Undertakings with specific reference to the transfer of insolvent undertakings – An Evolution of the South African Law.*

the employment perspective and not from a perspective conditioned by principles of property, insolvency or company law.

In respect to the intention of the legislator to protect employees from losing their jobs it stated further that,

"...a less literal and more purposive approach is justified in the context of Section 197. As stated earlier, the section is intended to protect employees whose security of employment and rights are in jeopardy as a result of business transfers'.[187]

The controversy over section 197 is over, resolved twice. Firstly, by the enactment of an amended section 197 in the LRA Amendment Act 2002 – that clarifies the intent of the original section and introduces a range of novel provisions, and subsequently, by the decision of the Constitutional Court in *NEHAWU v University of Cape Town.*[188]

The cumulative effect of the Constitutional Court judgment and the 2002 amendments is that the fundamental purpose of section 197 can no longer be in doubt. But, other controversies will follow. The novel provisions in the 2002 amendments still require interpretation and the fundamental question of what a "going concern" is requires clarification.[189]

Post-merger restructuring in commerce tends to shift the bias essentially towards capital, frequently resulting in job-shedding. According to SACCAWU, although the South African Labour Relations Amendment Act of 2002 provides for the protection of workers' acquired rights in case of transfer of ownership, whether by merger or acquisition, in practice new employers have been able to obtain indemnity from the previous employer against any employment liability. In other cases, acquirers have conditioned the transaction on the target, first implementing sizeable retrenchments and outsourcing arrangements for certain – allegedly – "non-core functions". Despite such

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[187] (LC) in *ILJ* 2005, 1056, 1068.
[188] Paul Benjamin, *Still Misunderstood: Transfers, outsourcing and labour-broking.*
[189] *ibid.*

pre-transaction reductions, the post-merger restructuring is itself replete with further redundancies.[190]

SACCAWU reports, furthermore, that the concentration of commerce in South Africa has been inimical to consumers' interests, tending to reduce competition and generate an increase in prices of foodstuffs and other household items. The end result of the consolidation process has been emergence of a reduced number of dominant wholesale-retail firms. Little in the way of investment in skills or job creation has resulted from the consolidation, and the overall experience of workers regarding South African M&As was mostly negative.[191]

6. South Africa: A Role Model for Kenya?

Section 197 of the Labour Relations Act of South Africa has gone a long way in protecting employees in a transfer of a business as a going concern. In Kenya, the employees aspect has not been protected as much, in fact, no law has been formulated as yet to this effect.

Thus, in a scenario where the South African insurer, Sanlam which holds a 50 per cent stake of Pan Africa Group indirectly through South Africa's African Life Group which it acquired in 2005, and which therefore controls Pan Africa Insurance Holdings' Kenya operations. The changes are partly as a result of an effort by Sanlam to have its local subsidiary acquire effective management control over the 60-year-old Kenyan operation which has led to the departure of senior staff and a long-serving director.[192]

However, were this case based in a South African context, would the departing staff have cited Section 186 of the Labour Relations Act, 2002, wherein the employee

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[190] Report for discussion at the Tripartite Meeting on the Employment Effects of Mergers and Acquisitions in Commerce, Geneva, 2003. International Labour Organization, p.20, 21.
[191] *ibid* at p. 21.
[192] Instead of acquisition of a majority stake which would trigger a compulsory takeover offer to minority shareholders at the Nairobi stock Exchange, Sanlam has opted instead to take control of the board of the Pan Africa's Kenyan operations group - The Standard (Financial Standard) dated Tuesday, August 7, 2007.

terminates a contract of employment after a transfer in terms of Section 197 because the new employer provided the employee "with conditions or circumstances that are substantially less favourable to the employee than those provided by the old employer"?[193] I should think not; as the Constitutional Court pointed out in the *University of Cape Town case,* everyone has a right to fair labour practice, including employers.

Therefore if an employer can establish that operational requirements are the reason for dismissal in the transfer context, then such dismissal would not be automatically unfair. They may be related to the transfer but the transfer as such would not be the main reason for the dismissal. It would be prudent to allow a lapse of time to intervene between to distance the dismissal from the transfer and to allow organizational efficiencies, in our case Sanlam's acquiring effective management control, to become readily apparent.

In yet another acquisition, or merger, as its being touted, involving yet another South African conglomerate of a Kenyan company. CFC Bank (a Kenyan Bank with vast related interests) plans to exchange a 96.3 per cent interest in Stanbic Kenya[194] with Stanbic Africa Holdings while the latter will get a 60 per cent stake in the CFC Bank Group.

The deal will see CFC Bank majority owner – Gambit Holdings – sell 50 million shares to Stanbic Africa Holdings that will in turn take up another 113 million new shares funded by CFC Bank reserves.

The deal is valued at 15 billion Kenya shillings (approximately 1.5 billion Rand) at a price a price of 96 Kenya Shillings (approximately 9.60 Rand) per share.

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[193] (2001) 22 *ILJ* 1421 (LC)

[194] A branch of Standard Bank known as Stanbic to avoid confusion with Standard Chartered Bank, which also operates in the country.

Under the proposed structure, CFC Bank will acquire Stanbic Kenya and create a new holding company called CFC Stanbic Holdings. The new bank to be named CFC Stanbic Bank will be listed at the Nairobi Stock Exchange.

To get to the crux of the matter of our study herein, in an interview with *Business Daily*, CFC Chairperson Mr. Charles Njonjo ruled out job losses. Said he;

'Our expected new size will indeed result in hiring of more staff as the bank will roll out new services to meet people need'.

However, with rationalization expected in the banking division due to close proximity of branches in the two major cities of Kenya, i.e. Nairobi and Mombasa, the prospect of layoffs appears real.

The foregoing will appear as a transfer of a business by one company acquiring majority shares of another, however, the fact that the same will herald a disposition of some assets such as branches, to consolidate operations would bring this transfer under section 197 LRA should this transfer have been in South Africa.

What a great help it would have been if Kenya had legislated such a law that would protect the employees of CFC Bank such as section 197 LRA protects employees in South Africa in these kinds of transactions.

All in all suffice it to state the importance of Section 197 of the Labour Relations Act in protecting the employees in a transfer of a business as a going concern.

7. Conclusion

This dissertation has looked at the effects of transfer of businesses as a going concern and business reorganization in relation to downsizing where the business has to reduce its workforce to either save costs, increase profits or take advantage of strategic opportunities. Earlier, such procedures were overseen by the common law; the common law offered little or no protection to the employees and the employers were able to ride roughshod over their workforce.

On the introduction of section 197 Labour Relation Act the employees greatly benefited from the protection accorded to them by this section. Given, that the employees did not have much say in the matter about their transfer, but all in all they were much better off in these circumstances than in the preceding situations.

In South Africa where there were numerous laws that were distinctly labour unfriendly, during the apartheid years, upon its collapse there has been a raft of legislation passed to right these injustices. The tendency thus was for the legislation geared for labour to be more overly protective of the workers. This has been seen to impede on commercial growth. However, the business community has various avenue of eradicating these barriers that come with heightened labour protection, rather than to find ways to evade their consequences and to negate their advantages to the employees. Such a suggestion would, for example, entail conducting an extensive due diligence exercise to ensure the new employer closes the transaction without undertaking a huge burden.

This is a much better way of conducting business and it surely curbs any ripple effects that would affect the economy of the country should there be a massive loss of employment arising from the numerous mergers and acquisitions transactions taking place in the country. This is definitely a better option rather than reducing the gains made on employee protection for the sake of 'making it cheaper to do business', which would consequently and inevitably in the long-run hurt the economy more, and subsequently actually slow down growth of commerce.

South African courts still do not have the concept 'down pat', but all in all bringing the transfer of a business, trade, undertaking or service under the ambit of section 197 is the surest way of extending this protection to every labourer who might be affected by any such transaction. There will be teething problems in the matter, but when finally the correct procedure in the process is established, the contradictions will reduce and the matter will be more succinctly addressed without much ado.

However, this might not be possible because as we said, the courts will deal with the issue of "going concern" in transfer of business on a case to case basis.

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ANNEXURE

LABOUR RELATIONS ACT

NO. 66 OF 1995

Assented to on 29 November 1995

Date of Commencement

11 November 1996

197. Transfer of contract of employment

(1) A contract of employment may not be transferred from one employer (referred to as "the old employer") to another employer (referred to as "the new employer") without the *employee*'s consent,

unless—

(a) the whole or any part of a business, trade or undertaking is transferred by the old employer as a going concern; or

(b) the whole or a part of a business, trade or undertaking is transferred as a going concern—

(i) if the old employer is insolvent and being wound up or is being sequestrated; or

(ii) because a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency.

(2)

(a) If a business, trade or undertaking is transferred in the circumstances referred to in subsection (1) (a), unless otherwise agreed, all the rights and obligations between the old employer and each *employee* at the time of the transfer continue in force as if they were rights and obligations between the new employer and each *employee* and, anything done before the transfer by or in relation to the old

employer will be considered to have been done by or in relation to the new employer.

(b) If a business is transferred in the circumstances envisaged by subsection (1)(b), unless otherwise agreed, the contracts of all *employees* that were in existence immediately before the old employer's winding-up or sequestration transfer automatically to the new employer, but all the rights and obligations between the old employer and each *employee* at the time of the transfer remain rights and obligations between the old employer and each *employee*, and anything done before the transfer by the old employer in respect of each *employee* will be considered to have been done by the old employer.

(3) An agreement contemplated in subsection (2) must be concluded with the appropriate person or body referred to in section 189(l).

(4) A transfer referred to in subsection (1) does not interrupt the *employee*'s continuity of employment. That employment continues with the new employer as if with the old employer.

(5) The provisions of this section do not transfer or otherwise affect the liability of any person to be prosecuted for, convicted of, and sentenced for, any offence.

Amended Labour Relations Act

Labour Relations Act (No. 66 of 1995)

as amended by the

Amendment - Afrikaans Labour Relations Act 1998, Amendment - Labour Relations Act 1996, Amendment - Labour Relations Act 1998, Amendment - Labour Relations Act 2000, and Amendment - Labour Relations Act 2002

Chapter 8: Unfair dismissal and unfair labour practice

197. Transfer of contract of employment

(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.

(1) If a transfer of a business takes place, unless otherwise agreed in terms of subsection (6) –

(a) the new employer is automatically substituted in the place of the old employer in respect of all contracts of employment in existence immediately before the date of transfer;

(b) all the rights and obligations between the old employer and an employee at the time of the transfer continue in force as if they had been rights and obligations between the new employer and the employee;

(c) anything done before the transfer by or in relation to the old employer, including the dismissal of an employee or the commission of an unfair labour

practice or act of unfair discrimination, is considered to have been done by or in relation to the new employer; and

(d) the transfer does not interrupt an employee's continuity of employment, and an employee's contract of employment continues with the new employer as if with the old employer.

(2)

(a) The new employer complies with subsection (2) if that employer employs transferred employees on terms and conditions that are on the whole not less favourable to the employees than those on which they were employed by the old employer.

(b) Paragraph (a) does not apply to employees if any of their conditions of employment are determined by a collective agreement.

(3)

Subsection (2) does not prevent an employee from being transferred to a pension, provident, retirement or similar fund other than the fund to which the employee belonged prior to the transfer, if the criteria in section 14(1) (c) of the *Pension Funds Act, 1956* (Act No. 24 of 1956), are satisfied[53a].

(4)

(a) For the purposes of this subsection, the collective agreements and arbitration awards referred to in paragraph (b) are agreements and awards that bound the old employer in respect of the employees to be transferred, immediately before the date of transfer.

(b) Unless otherwise agreed in terms of subsection (6), the new employer is bound by –

(i) any arbitration award made in terms of this Act, the common law or any other law;

(ii) any collective agreement binding in terms of section 23; and

(iii)any collective agreement binding in terms of section 32, unless a commissioner acting in terms of section 62 decides otherwise.

(5)

(a) An agreement contemplated in subsection (2) must be in writing and concluded between –

(i) either the old employer, the new employer, or the old and new employers acting jointly, on the one hand; and

(ii) the appropriate person or body referred to in section 189(1), on the other

(b) In any negotiations to conclude an agreement contemplated by paragraph (a), the employer or employers contemplated in subparagraph (i), all relevant information that will allow it to engage effectively in the negotiations.

(c) Section 16(4) to (14) applies, read with the changes required by the context, to the disclosure of information in terms of paragraph (b).

(6) The old employer must –

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

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

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

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

(b) conclude a written agreement that specifies –

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

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

(c) disclose the terms of the agreement contemplated in paragraph (b) to each employee who after the transfer becomes employed by the new employer; and

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

(7) For a period of 12 months after the date of the transfer, the old employer is jointly and severally liable with the new employer to any employee who becomes entitled to receive a payment contemplated in subsection (7) (a) as a result of the employee's dismissal for a reason relating to the employer's operational requirements or the employer's liquidation or sequestration, unless the old employer is able to show that it has complied with the provisions of this section.

(8) The old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to the transfer.

(9) This section does not affect the liability of any person to be prosecuted for, convicted of and sentenced for, any offence.

53a. Section 14(1)(c) of the Pensions Funds Act requires the registrar to be satisfied that any scheme to amalgamate or transfer funds is reasonable and equitable, and accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the fund rules, and to additional benefits which have become established practice.

197A Transfer of contract of employment in circumstances of insolvency

(1) This section applies to the transfer of a business –

(a) if the old employer is insolvent; or

(b) if a scheme of arrangement or compromise is being entered into to avoid winding up sequestration for reasons of insolvency.

(2) Despite the *Insolvency Act, 1936* (Act No. 24 of 1936), if a transfer of a business takes place in the circumstances contemplated in subsection (1), unless otherwise agreed in terms of section 197(6) –

(a) the new employer is automatically substituted in the place of the old employer in all contracts of employment in existence immediately before the old employer's provisional winding up or sequestration;

(b) all the rights and obligations between the old employer and each employee at the time of the transfer remain rights and obligations between the old employer and each employee;

(c) anything done before the transfer by the old employer in respect of each employee is considered to have been done by the old employer;

(d) the transfer does not interrupt the employee's continuity of employment and the employee's contract of employment continues with the new employer as if with the old employer.

(3) Section 197(3), (4), (5) and (10) applies to a transfer in terms of this section any reference to an agreement in that section must be read as a reference to an agreement contemplated in section 197(6).

(4) Section 197(5) applies to a collective agreement or arbitration binding on the employer immediately before the employer's provisional winding up or sequestration.

(5) Section 197(7), (8) and (9) does not apply to a transfer in accordance with this section.