THE APPLICATION OF SECTION 197
OF THE LABOUR RELATIONS ACT
IN AN OUTSOURCING CONTEXT

By

LYNN BIGGS

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SUPERVISOR: PROF JA VAN DER WALT
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SUMMARY

Section 197 of the Labour Relations Act (LRA) in both its original form and in its current form caused much confusion and debate. Originally it was interpreted that section 197 allowed for the automatic transfer of employees in cases where there was a transfer of the whole or part of a business, trade or undertaking as a going concern. That meant that the contracts of employment transfer to the new owner and that the employees could not refuse to be transferred. Various judges were tasked with interpreting this section in its original form and thus different interpretations emerged with the Labour Appeal Court ultimately deciding in the NEHAWU v University of Cape Town matter that employers involved in the transfer can decide between them, not to transfer the employees. The LAC further held that “outsourcing” does not necessarily entail a transfer of a business.

Section 197 was amended in 2002 and the effect of the provisions is that the old employer is not required to seek the consent of the employees before their contracts are transferred and that the employment contracts transfer automatically. However, the current section has also raised some difficulties especially relating to: when does a transfer of a business as a going concern take place; what constitutes a “business”; when is an entity part of a business, trade, undertaking or service? A more glaring controversy relates to whether section 197 applies to "second-generation contracting out or outsourcing”.

All provisions of the LRA should be interpreted in the context to advance economic development, social justice, labour peace and democratisation of the workplace. One of the primary objects of the LRA is to give effect to and to regulate the fundamental rights of the Constitution of the Republic of South Africa, 1996. Thus section 197 is to be interpreted in light of the objectives of the LRA as well as to promote the spirit, purport and objects of the Bill of Rights.

The common law and international law are both important sources of comparison. The common law allows employers who transfer businesses free to decide whether or not the transfer will include the employees of the transferor. International law, particularly the European Union and the United Kingdom, favour the approach that when an entity is transferred, it retains its identity after the transfer and the safeguarding of employee rights in the context of business transfers. European and English jurisprudence have shown that almost any combination of events can constitute a transfer of a business.
Case law regarding the current section 197 once again raised debate especially relating to the interpretation of the word “service” which was added to section 197 by the amendment. The LAC in the **SAMWU v Rand Airport Management Company** ruled that a contract to outsource for example gardening functions is a service within the meaning of section 197. Thus such arrangements could result in the automatic transfer of affected employees from the outsourcer to the contractor.

Further confusion and debate has arisen as a result of the decision of the **COSAWU v Zikhethele Trade (Pty) Ltd** matter which held that there may be automatic transfers in cases of second-generation outsourcing, meaning when the outsourcing contract changes hands from one contractor to another, section 197 would apply and employees concerned would transfer automatically. The implications of such an interpretation could have vast consequences.

In conclusion, it all boils down to the interpretation and application of section 197. Some authors are of the view that section 197 should be widely interpreted thus the proper protection of employee rights may require the courts to construe section 197 more widely than narrowly. The preferred interpretation is that of Wallis who is of the view that section 197 should be confined to the transfer of businesses and to that subject alone.
CHAPTER 1
INTRODUCTION

Section 197\(^1\) of the Labour Relations Act\(^2\) (LRA) has long been a source of confusion and concern.\(^3\) It has generally been thought that when one company transfers part of its business to another, the contracts of the affected workers transfer automatically to the other company. However, at least one judge of the Labour Court thought otherwise. Mlambo J in *NEHAWU v University of Cape Town & others*\(^4\) held that “outsourcing” does not necessarily entail a transfer of business.\(^5\)

Players on the corporate stage constantly change their make-up and composition.\(^6\) Not all outsourcing arrangements will amount to a transfer of a going concern, but this is a possibility.\(^7\) All relevant facts have to be weighed up and there is no single easy test.\(^8\)

The provisions of the original section 197 (prior to the 2002 amendments), Seady AJ in *Schutte & others v Powerplus Performance (Pty) Ltd & another*\(^9\), held, “were part of the Act’s mechanisms to provide security of employment in times of change”.

It was generally thought that the original section 197 was intended to achieve two objectives. The first to protect employees whose employers decide to sell or otherwise transfer their businesses to others; the second is to lessen the burden that the law would otherwise place on employers who engage in that exercise.\(^10\)

The provisions of the LRA via the original section 197 attempted to cover the implications for staff affected by sales or transfers of going concerns.\(^11\)

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\(^1\) S197 Transfer of contract of employment.
\(^3\) Bosch “*Aluta continua*, or closing the generation gap: Section 197 of the LRA and its application to outsourcing” 2007 *Obiter* 84. [Hereinafter referred to as “*Aluta continua*”].
\(^4\) [2000] 7 BLLR 803 (LC).
\(^5\) Grogan & Gauntlett “Outsourcing workers – A fresh look at section 197” 2000 *EL* 15. [Hereinafter referred to as “Outsourcing workers”].
\(^6\) Grogan & Gauntlett “Going concerns: Unilateral transfers of service contracts” 1999 *EL* 14. [Hereinafter referred to as “Unilateral transfers of service contracts”].
\(^7\) Beaumont “Coping with corporate re-organisation: Outsourcing - must sub-contractors take over client’s staff?” 1999 *Beaumonts Service Beaumont Express* 556. [Hereinafter referred to as “Outsourcing”].
\(^8\) Beaumont “Outsourcing” 556.
\(^9\) [1999] 2 BLLR 169 (LC).
\(^10\) Grogan “A twist on transfers: LAC reinterprets section 197” 2002 *EL* 9. [Hereinafter referred to as “A twist on transfers”].
\(^11\) Beaumont “Coping with corporate re-organisation: Section 197 Transactions – further confusion” 2000 *Beaumonts Service Beaumont Express* 321. [Hereinafter referred to as “Section 197 Transactions”].
However, rigidity over transfers of going concerns under the original section 197 required clarification.\textsuperscript{12}

Case law relating to the transfer of businesses will be considered in the light of the original section 197 as well as with regard to outsourcing arrangements. However, reliance placed on case law around the original section 197 is to be treated with caution because of the amendments to the LRA in 2002.\textsuperscript{13}

It was anticipated that the 2002 amendments to the LRA would iron out some of the more glaring anomalies that surfaced in the new labour relations regime since its inception.\textsuperscript{14}

However, in both its original and amended forms, section 197 continued to generate much debate. Much of the debate turned on the question: when does a transfer of a business as a going concern actually take place?\textsuperscript{15}

Despite the amendments to section 197, subsequent court decisions have demonstrated that the applicability of the section remains contested terrain.\textsuperscript{16}

The application of section 197 has given rise and still could give rise to numerous difficulties. These difficulties include: what constitutes a “business” for the purposes of section 197; and particularly around when an entity is part of a business, trade, undertaking or service.\textsuperscript{17}

The word service was introduced into section 197 in 2002 and seems to have extended the reach of this section to cover many outsourcing contracts.\textsuperscript{18}

Many of the cases shaping the scope of section 197 have related to cases involving so-called outsourcing.\textsuperscript{19}

\textsuperscript{12} Beaumont “Legislation and Strategy: Department of Labour’s 5 year plan – For every action there is an equal and opposite reaction – Newton’s second law of motion” 1999 Beaumonts Service Beaumont Express 19 23. [Hereinafter referred to as “Department of Labour’s 5 year plan”].
\textsuperscript{13} Beaumont “Coping with re-organisation: Business transfers – going, going, gone” 2005 Beaumonts Service Beaumont Express 135. [Hereinafter referred to as “Business transfers”].
\textsuperscript{14} Grogan & Gauntlett “Welcome changes” 2000 EL 3.
\textsuperscript{15} Grogan & Gauntlett “Second-generation outsourcing: The reach of section 197” 2005 EL 10. Hereinafter referred to as “Second-generation outsourcing”.
\textsuperscript{16} Bosch “Aluta continua” 84.
\textsuperscript{17} Bosch “Of business parts and human stock: Some reflections on section 197(1)(a) of the Labour Relations Act” 2004 ILJ 1865 1882. [Hereinafter referred to as “Of business parts and human stock”].
\textsuperscript{18} Beaumont “Business transfers” 135.
\textsuperscript{19} Bosch “Aluta continua” 85.
In terms of current section 197, an outsourcing arrangement may constitute a transfer of a business as a going concern. But what is the position when the outsourcer cancels the contract with the original contractor and concludes a new contract with another?  

Outsourcing was dealt a blow when the Labour Court in *SAMWU & others v Rand Airport Management Company (Pty) Ltd*[^21] decided that such arrangements may result in the automatic transfer of affected employees from the outsourcer to the contractor; now the Labour Court in *COSAWU v Zikhethele Trade (Pty) Ltd & another*[^22] has held that there may be further transfers when the outsourcing contract changes hands.  

The current controversy relates to whether the section can apply to so-called “second-generation contracting-out”.[^24]  

[^20]: Grogan & Gauntlett “Case Roundup: Double transfer” 2005 *EL* 19.  
[^22]: [2005] 9 BLLR 924 (LC).  
[^23]: Grogan & Gauntlett “Second-generation outsourcing” 10.  
[^24]: Bosch “*Aluta continua*” 85.
CHAPTER 2
THE CONSTITUTION, THE COMMON LAW, AND INTERNATIONAL INFLUENCES

2.1 THE CONSTITUTIONAL EFFECT

Provisions in a statute are not to be interpreted narrowly within the confines of a particular section. The provisions should be interpreted in the context of the LRA to advance economic development, social justice, labour peace and democratisation of the workplace by fulfilling the primary objects of the LRA which include to give effect to and regulate the fundamental rights under section 27 of the Interim Constitution\(^\text{25}\) and now section 23 of the Constitution\(^\text{26} \, 27\).

Employees are entitled under the Constitution to fair labour practices and this together with the objectives of the LRA, are to be used in interpreting a section such as section 197 of the LRA.\(^\text{28}\) [See Chapter 3 and 4 below] Our Constitution is unique in constitutionalising the right to fair labour practices. The concept is not defined and is probably incapable of precise definition. What is fair depends on the circumstances of a particular case and essentially involves a value judgment.\(^\text{29}\)

Transfers of going concerns often bring about inherent tension between employers and employees. As the concept of fair labour practices applies to both employers and employees, section 197 must be interpreted in such a way, which is consistent with section 23, but also which is fair. Fairness and rigidity are uneasy bed-fellows and some element of flexibility and balance is required.\(^\text{30}\)

Section 39(2) of the Constitution requires courts to promote the spirit, purport and objects of the Bill of Rights when interpreting legislation. That is emphasised by the LRA itself, which states that one of the primary objects of the Act is to give effect to the right to fair labour practices. It also stipulates that the Act must be interpreted to give effect to its primary objects and the Constitution.\(^\text{31}\)

\(^{27}\) Beaumont "Coping with re-organisation: The real purpose behind section 197" 2003 Beaumonts Service Beaumont Express 343. [Hereinafter referred to as "The real purpose behind section 197".]
\(^{28}\) Beaumont "Outsourcing" 557.
\(^{29}\) Beaumont "The real purpose behind section 197" 344.
\(^{30}\) Beaumont "The real purpose behind section 197" 344.
\(^{31}\) Bosch "Aluta continua" 94.
2.2 COMMON LAW

Under the common law, the closure of a corporate employer (whether by insolvency, sale, merger, take-over or for any other cause) resulted in the termination of the contracts of employment between the employer and the employees. In these circumstances, the employer was required to terminate the contracts of the employees on notice. An employer contemplating closure could not under the common law compel its employees to work for another employer.32

The employment relationship in common law is personal.33 Under the common law, employment relationships are personal to the parties and may not be transferred or substituted without the consent of the original parties.34 The employment contract is a personal relationship between an employer and employee. Both of these parties cannot unilaterally substitute themselves with another person. Under common law an employer cannot unilaterally instruct an employee to work for another employer and likewise employees cannot force the buyer of a business to take them on.35

Under the common law, employees were deemed to have been discharged by the former employer, whether or not they had been offered positions in the transformed structure. If they did not want to work under it, they could not be forced to do so. That was because an employment contract was deemed in law to be one of so personal a nature that it could not be transferred from one employer to another without the employee’s consent. This was one difference between the free market employee and the slave.36

The rule against non-consensual transferability of employment did not create major problems under the common law. The reluctant employee could simply be paid off on notice. However, as the size of the pay-outs to which employees became entitled by law or by collective agreement increased, so employees became a potential major factor in the corporate jungle.37

In terms of the generally accepted approach to statutory interpretation, the legislature does not intend to change the common law unless it expressly or by necessary implication says

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33 Beaumont “Section 197 Transactions” 322.
35 Beaumont “To the brink and back again – Insolvency and Labour issues” 1999 Beaumonts Service Beaumont Express 57. [Hereinafter referred to as “To the brink and back again”].
36 Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
37 Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
otherwise. The common law leaves employers who transfer businesses free to decide whether or not the transfer will include the transferor’s employees.

The Industrial Court recognised the need to protect employees under these circumstances and noted the absence of any mechanism for the transfer of employees’ contracts of employment to the purchaser, but failed to offer a remedy.

2.3 INTERNATIONAL CONSIDERATIONS

2.3.1 Transfer of business

International decisions on the transfer of a business can be classified into broad and narrow interpretations.

The European Court of Justice has favoured a broader interpretation and the converse is applicable in the United Kingdom (UK). There have been some cases which have regarded the outsourcing of service or the mere transfer of an activity or services as sufficient to constitute a transfer of a business whereas other decisions have held that for this outcome there be some concomitant transfer of significant assets (tangible or intangible) or the taking over by the new employer of a major part of the workforce.

The test for the transfer of a going concern laid down by the European Court of Justice for the purposes of the application of directives safeguarding employee rights in the context of business transfers, is that when an economic entity is transferred it retains its identity after the transfer. This involves a two-stage test, namely (a) whether there is an “economic entity” that (b) retains its identity after the transfer. Bosch is of the view that a similar approach should be adopted in South Africa.

There have been some interesting decisions in the UK, for example, that a transfer of an

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38 Grogan “A twist on transfers” 11.
39 Grogan “A twist on transfers” 11.
41 Beaumont “Outsourcing” 558.
42 Beaumont “Outsourcing” 558.
43 Bosch “Of business parts and human stock” 1866.
undertaking has arisen where one sub-contractor is substituted for another. In other words, there was an existing outsourcing arrangement, which was then moved from supplier A to supplier B.\textsuperscript{44}

Seady AJ, in \textit{Schutte \& Others v Powerplus Performance (Pty) Ltd \& another}\textsuperscript{45} turned for guidance to interpretations of the Acquired Rights Directive of the Council of the European Communities:

“Numerous factors have been regarded as indicative of a transfer of a business, but no single factor has been regarded as conclusive of this determination. For example, a sale of assets may indicate a transfer within the meaning of the Directive, but not necessarily. Conversely, the fact that no assets were sold does not mean that there has been no transfer of a business. Likewise, the transfer of a significant number of employees and the immediate continuation or resumption of a service or function is regarded as indicative, but not conclusive of a transfer…”\textsuperscript{46}

Seady, AJ, also considered the jurisprudence of the English courts in which it had been held that transfers of refuse collection, cleaning and paediatric services from a local authority to outside contractors were transfers within the meaning of British legislation. Although they were decided under specific legislation, the judgments of the English courts indicate that our courts could well go the same way.\textsuperscript{47}

The exhaustive European Union approach that these provisions cover a multitude of outsourcing examples militates against businesses distinguishing between core and peripheral businesses and the creation of empowerment ventures regarding the latter.\textsuperscript{48}

The European Court of Justice has noted that the object of the transfer is an “organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective”.\textsuperscript{49} But that court has also stressed that the mere fact that such an activity is sold does not necessarily mean that it amounts to a “transfer of business” for the purposes of the directive that governs such matters in Europe. That is only the beginning of the enquiry.\textsuperscript{50}

In the European and UK jurisprudence there has been a struggle between the courts on the one hand and business entities on the other over what constitutes the transfer of a business. The

\textsuperscript{44} Beaumont “Outsourcing” 558.
\textsuperscript{45} [1999] 2 BLLR 169 (LC).
\textsuperscript{46} \textit{Schutte \& others v Powerplus Performance (Pty) Ltd \& another} [1999] 2 BLLR 169 (LC) 35.
\textsuperscript{47} Grogan \& Gauntlett “Unilateral transfers of service contracts” 16.
\textsuperscript{48} Beaumont “Department of Labour’s 5 year plan” 23.
\textsuperscript{49} Grogan \& Gauntlett “Outsourcing workers” 17 18.
\textsuperscript{50} Grogan \& Gauntlett “Outsourcing workers” 18.
cases show that almost any combination of events can potentially constitute a transfer of a business.⁵¹

It is unnecessary for the transfer to arise from a contract and it is also unnecessary for there to be any relationship, contractual or otherwise, between transferor and transferee.⁵²

The European and English jurisprudence is neither clear nor consistent. There are statements in judgments that suggest that there are factual findings that the situation presented are transfer of undertakings when they are nothing more than statements that such situations could possibly be transfers of undertakings.⁵³

2.3.2 What happens to contracts of employment?

Zondo JP in <i>NEHAWU v University of Cape Town</i>⁵⁴ began by observing that there was “no doubt” that the drafters of the LRA were seeking to give effect to a directive issued by the Council of the European Communities in 1977, dealing with the transfers of businesses “as a result of a legal transfer or merger”, the directive provides, among other things, that “the transferor’s rights and obligations arising from the contract of employment or from an employment relationship existing on the date of a transfer, be transferred to the transferee. Article 4 of the directive states that the transfer of a business “shall not in itself constitute grounds for dismissal by the transferor”.⁵⁵

The United Kingdom Transfer of Undertakings (Protection of Employment) Regulations, provide that, subject to certain exceptions, the transfer of a business “shall not operate so as to terminate the contract of employment of a person by the transferor … but any such contract which would otherwise have been terminated by the transferee shall have effect after the transfer as if originally made between the person so employed and the transferee.”⁵⁶

When dealing with the effects of the transfer of a business on the employment contracts of the transferring employer, the European directive and the UK regulations have a virtue which the original section 197 [See Chapter 3 below] lacks: clarity.⁵⁷ Both the directive and the regulation leave no doubt that, when a business changes hands, so too, do the contracts of employment

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⁵² Wallis 5.
⁵³ Wallis 8.
⁵⁵ Grogan “A twist on transfers” 12.
⁵⁷ Grogan “A twist on transfers” 12.
attached to that business. Both instruments leave no doubt that, in such circumstances, the transfer of contracts of employment is automatic. This means that the consent of the employers is quite irrelevant in this regard; the only choice that the employers have is not to agree to the business transfer itself.\textsuperscript{58}

Zondo JP was forced to go to some length when seeking to establish whether the similarities and differences between the UK regulation and the European directive and the original section 197 indicate whether or not the original section 197 should be read as if it also seeks to ensure that the contracts of employees affected by transfer or merger of the businesses of their employers transfer automatically, unless the employees agree otherwise.\textsuperscript{59}

According to Zondo JP, the only material difference in this regard between the original section 197 and the European directive is that neither the directive nor the UK regulation use the term "going concern" when they deal with transfers of businesses.\textsuperscript{60}

The European directives and the UK regulations are solely and specifically directed at the protection of employees’ continuity of employment.\textsuperscript{61}

\subsection{2.3.3 Compliance with international law}

The long title of the LRA sets out one of the objectives of the Act as “to change the law governing labour relations and, for that purpose – to give effect to the public international law obligations of the Republic relating to labour relations”.

Section 3(c) of the LRA requires that “any person applying this Act must interpret its provisions- (c) in compliance with the public international law obligations of the Republic”.

The Constitutional Court (CC) in \textit{NEHAWU v University of Cape Town}\textsuperscript{62} said that the foreign jurisprudence can “provide some insight for a proper interpretation and application of section 197”.\textsuperscript{63}

\begin{footnote}
\textsuperscript{58} Grogan “A twist on transfers” 12.
\textsuperscript{59} Grogan “A twist on transfers” 12.
\textsuperscript{60} Grogan “A twist on transfers” 12.
\textsuperscript{61} Wallis 5.
\textsuperscript{62} 2003 (3) SA 1 (CC).
\textsuperscript{63} 2003 (3) SA 1 (CC) par 47.
\end{footnote}
The Labour Court in *COSAWU v Zikhethele Trade (Pty) Ltd & another*\(^6^4\) held that foreign jurisprudence has the status of a clear guide to the content of our law. Wallis’ view is that *Zikhethele’s* elevation of the status of foreign jurisprudence is a fundamental error particularly in relation to a crucial departure from the plain language of section 197.\(^6^5\)

Wallis says that “the proper approach must be to start with the language of our own legislation not some preconception of what the law should be or some preconception of what the law should offer to employees or what rights it should confer upon employers in these diverse circumstances”.\(^6^6\)

However, Bosch argues that our courts are not bound to follow the European courts, but should be guided by their experience.\(^6^7\)
CHAPTER 3
SECTION 197 OF THE LRA PRIOR TO THE 2002 AMENDMENT

3.1 INTRODUCTION

The common law can lead to both abuse and job insecurity for employees and corrective measures were found in the original section 197 of the LRA.68

Prior to the introduction of the original section 197 in 1996, employees were often exploited or disadvantaged in cases of transfers, which were used selectively to employ persons in the new undertaking and invariably the purchaser’s employees prevailed over the seller’s in the race for positions.69

The drafters of the LRA claimed to have resolved the common law problem by making provision for the “automatic transfer of contracts of employment to the transferee provided that the employees consent to the transfer”.70

However, key concepts used in the section were not defined, the section used words and phrases such as “transfer” and “transfer as a going concern” without defining them and at the same time use of this phrase limited the sphere of application of the original section 197.71

3.2 ANALYSIS OF THE ORIGINAL SECTION 197

The original section 197, prior to the substitution of section 197 by section 49 of the Labour Relations Amendment Act,72 read as follows:

“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 —

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68 Beaumont “To the brink and back again” 57.
69 Beaumont “Outsourcing” 557.
70 Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
72 Act 12 of 2002.
(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(1).

(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."

The original section 197 consists of five subsections. The first provides that a contract of employment may not be transferred without the employee’s consent other than in the circumstances of a sale of a business as a going concern. The second requires the terms of a contract of employment to remain unchanged if the contract is transferred in the circumstances referred to in the first subsection. All the old employer’s rights and obligations are accordingly transferred to the new employer. The second does, however, allow all the terms to be changed by agreement and the third subsection clarifies that such agreement should be with the appropriate person or body referred to in section 189(1). The fourth subsection stipulates that in the event of a transfer of a contract of employment as contemplated in the first subsection, there is to be no interruption in the continuity of the employee’s period of employment. Lastly, the fifth subsection clarifies the limits of the transfer of obligations in terms of the second subsection by providing that
criminal liability in relation to employment issues is not transferred to the new employer with the contract of employment.73

The LRA, as it was then, allowed, in certain circumstances, for the automatic transfer of staff in cases of corporate re-organisation. This arose where there was a transfer of the whole or part of a business, trade or undertaking as a going concern.74 The original section 197 provided, first, that when employers transfer the whole or part of the business as a going concern, the contracts of employment transfer to the new owner; second, that employees cannot refuse to be transferred with the business, thus ensuring that the transferring employer is not compelled to retrench the employees and pay them severance benefits.75

The original section 197 restated the common law principle and altered it when section 197 circumstances prevailed. Here employment may be transferred without prior consultation or consent.76 The common law principle is restated in the original section 197 which goes on to specify an exception where this consent is unnecessary, that is where the transfer of employment is automatic. The consequences in these cases are rigidly spelled out – the status quo of the service contract is preserved and save where the business is rescued out of insolvency so is the employment history.77 The trigger to this exception is the transfer of the whole or part of a business as a going concern. The words "going concern" is not defined nor is the applicable test.78

The original section 197 began by saying that a contract of employment may not be transferred from one employer ("the old employer") to another employer ("the new employer") without the employee’s consent, unless two sets of circumstances applied.79 One was where "the whole or part of a business, trade or undertaking is transferred by the old employer as a going concern".80 The other was where the business, trade or undertaking is transferred, again in whole or in part, if the old employer is insolvent and is being wound up or sequestrated or is under a scheme of arrangement aimed at avoiding winding up or sequestration.81

The section reinforced the common law position that a contract of employment was personal in

74 Beaumont “Outsourcing” 556.
75 Grogan “A twist on transfers” 9.
76 Beaumont “Section 197 Transactions” 322.
79 Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
80 S197(1)(a).
81 Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
nature and could not be transferred without the consent of the employee. An exception applied where an economic entity was taken over and remained in existence. Here, the contracts of employment were automatically transferred.\textsuperscript{82} In other words, the common-law rule against non-consensual transfer of contracts of employment was entrenched, except in the case of transfers so described or insolvencies.\textsuperscript{83}

The automatic transfer arose because, the whole or any part of a business, trade or undertaking, was transferred by an old employer to a new employer as a going concern. In these situations, all the rights and obligations between the previous employer and each employee at the time of the transfer, continued in force with the new employer according to the original arrangements. The new employer inherited the employees and their employment relationship, except any liability for criminal offences.\textsuperscript{84}

The consequences foreseen by the original section 197 came into play only once it has been established that the business (or trade or undertaking) has been transferred as a going concern.\textsuperscript{85}

Furthermore, “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”.\textsuperscript{86}

Whilst the original section 197 provided for the automatic transfer of staff, the new and the old employers needed to give consideration to the practical implications of implementation. If severe difficulties were envisaged then consultations should have been initiated beforehand.\textsuperscript{87}

The original section 197 only dealt with individual contracts of employment and not collective agreements.\textsuperscript{88} Here the new employer was free to adopt or renegotiate the collective agreements unless these agreements expressly bound the buyer through succession provisions. Collective agreements survived transactions, which did not fall under section 197 unless terminated in accordance with the agreement, whereas they did not survive transactions, which fell within the ambit of the then section 197.\textsuperscript{89} Whilst the desire to facilitate continuity of collective bargaining was appreciated, transfers often resulted in a change of economic sector and the receiving employer could have established collective bargaining relationships and structures. The scope of

\textsuperscript{82} Beaumont “Outsourcing” 556.
\textsuperscript{83} Grogan & Gauntlett “Unilateral transfers of service contracts” 14.
\textsuperscript{84} Beaumont “Outsourcing” 556.
\textsuperscript{85} Olivier & Smit “Transfer of a business, trade or undertaking” 1999 \textit{De Rebus} 83.
\textsuperscript{86} S197(2)(a).
\textsuperscript{87} Beaumont “Outsourcing” 560.
\textsuperscript{88} Beaumont “To the brink and back again” 58.
\textsuperscript{89} Beaumont “To the brink and back again” 61.
registration of trade unions may have excluded the old trade unions from representation of employees in the new economic sector.  

The contracts of employment to be transferred were those in existence immediately before the transaction and which must be transferred automatically.

Section 197 (the original) tried to strike a balance between commercial interests and social policy. For a transfer of a business to be covered by the then section 197, two requirements were to be met. Firstly, that an economic entity, consisting of an organised grouping of resources was transferred, and secondly, the economic entity retained its identity after the transfer. Outsourcing and subcontracting would in most cases not constitute a section 197 transaction based on this definition.

The negative features of the then LRA included:
- the automatic transfer of all existing staff in section 197 transactions; and
- the impracticality of transfer of collectivism in section 197 transactions.

The original section 197 prohibited transfers of employment without the consent of employees and raised the one exception, that is, where there is a transfer of a going concern. It was silent about the rights of the employers. By implication then the legislature did not intend to amend their common law rights; they were at liberty to define what was included in this context.

Although the original section 197 did not give rise to as much litigation as might have been expected, it was generally accepted that the provision meant what it apparently said. Whenever an employer agreed to transfer the whole or part of its business to another employer, the new employer had to take the employees of the transferring employer into its service whether or not it wished to do so. The employers had no choice in the matter; unless the employees of the transferring employer agreed otherwise, a business could not be sold, merged or otherwise transferred without the whole or affected part of the workforce of the transferred business. The

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91 Beaumont “Labour statutes” 303.
92 Olivier & Smit 83.
93 Beaumont “Labour statutes” 302.
94 Beaumont “Labour statutes” 313.
95 Beaumont “Dramatic new case law” 137.
96 Grogan “A twist on transfers” 9.
only way in which the new employer could avoid taking over the old employer’s employees was to decline to accept the transfer of the business.\textsuperscript{97}

3.3 CASE LAW RELATING TO THE ORIGINAL SECTION 197

3.3.1 Schutte & others v Powerplus Performance (Pty) Ltd & another\textsuperscript{98}

The question was whether the contracting-out of a service or function (namely the servicing of vehicles) from the first respondent (its core business being the rental of vehicles) to the second respondent constituted a transfer as a going concern for purposes of section 197. The applicants alleged that there was a transfer of a part of the business as a going concern while the respondents alleged that there was actually a closure of its workshops and outsourcing of its services and maintenance work.\textsuperscript{99}

Everything depended on whether the agreement entered into amounted to a transfer of the whole or part of the business. If that were the case, the new employer would assume all the rights and obligations that the old employer had towards its former employees, which would include the obligation to go on paying them what they had previously earned. The two employers predictably argued that what had happened was not a transfer of business, but the closure of the workshops and an “outsourcing” of its services and maintenance work.\textsuperscript{100}

If the transaction was a closure of the workshops, then the staff concerned would have to be retrenched. Alternatively, if there had been a transfer of the undertaking, then section 197 would have applied with the result that the existing staff would have automatically been transferred to the new employer on their existing terms and conditions of employment. The court considered a number of factors and found them to be in favour of an undertaking, the most significant of which was that the economic entity of the workshops remained after the event.\textsuperscript{101}

Seady, AJ, held that section 197 struck to the very heart of the conflict between the employer’s interest in the efficiency or survival of the undertaking and the employee’s interest in job

\textsuperscript{97} Grogan “A twist on transfers” 9.
\textsuperscript{98} [1999] 2 BLLR 169 (LC).
\textsuperscript{99} Olivier & Smit 83.
\textsuperscript{100} Grogan & Gauntlett “Unilateral transfers of service contracts” 15.
\textsuperscript{101} Beaumont “Outsourcing” 561.
Seady AJ, was able to distil an approach:

“that examines substance and not form; that weighs the factors that are indicative of a transfer of business from those that are not; that makes an overall assessment of the facts, not treating any one as conclusive in itself.”

The court considered the following factors:

- The transfer was contractually foreseen.
- Stock was to be taken over.
- The new employer was to use the same premises.
- There was almost no interruption in the continuation of the workshop activities by the new employer.
- There was a limited transfer of management to the new employer.
- A close relationship existed between the old and new employer, in the sense that the old shareholder held 50% of the shares in the new concern.

However, the court found it unnecessary, given the indications of a transfer, to decide the question that an outsourcing operation could fall within the terms of section 197.

The Court did not expressly hold that a transfer of the whole or part of a business from one employer to another inevitably and ex lege results in the transfer of the contracts of service between the old employer and its employees to the new employer. The Court held that the contracts had been transferred as a result of the sale of the business by which they had previously been employed.

The court observed that section 197 ensured employees continuity of employment when their employers changed.

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102 Grogan & Gauntlett “Unilateral transfers of service contracts” 15; Schutte & others v Powerplus Performance (Pty) Ltd & another [1999] 2 BLLR 169 (LC) 30.
103 Schutte & others v Powerplus Performance (Pty) Ltd & another [1999] 2 BLLR 169 (LC) 42.
104 Olivier & Smit 83.
105 Grogan & Gauntlett “Outsourcing workers” 15.
106 Grogan & Gauntlett “Unilateral transfers of service contracts” 16.
107 Grogan “A twist on transfers” 10.
In accordance with the *Foodgro* decision in the Labour Appeal Court (LAC), the commonly accepted practice about the original section 197 was to determine objectively whether or not a particular transaction amounted to a transfer as a going concern. An affirmative answer, lead to the automatic transfer of employees to the buyer.\(^{109}\)

Following a transfer of a going concern, Keil concluded a new contract of employment with the purchaser in terms of which she lost accrued service. She was retrenched and her severance pay was calculated on service with Foodgro and not her former employer. She was successful in her challenge as section 197(4) guaranteed continuity of service with the new employer.\(^{110}\)

The question whether contracts of employment are automatically transferred whether the seller and the purchaser want that or not was never an issue. There was a consensual transfer amongst the parties. The case concerned section 197(4) and not section 197(1), accordingly the judge’s remarks regarding section 197(1) are not binding.\(^{111}\)

Froneman DJP’s remarks included:\(^{112}\)

- Purpose of the original section 197 was to protect employees and not to assist the purchaser as the common law did this.
- The status quo benefits under section 197 secured advantages for employees not previously enjoyed.
- Employees transferred under section 197 could resign.
- New employees subject to additional sanctions/remedies because of transfers of employment.

*Foodgro* made no attempt to define a going concern or to determine the intention behind section 197(1); it was unnecessary as section 197(4) was the focal point.\(^{113}\)

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\(^{111}\) Beaumont “Dramatic new case law” 138.


\(^{113}\) Beaumont “Dramatic new case law” 138.
The first hint of a change of view occurred in this matter.

The Labour Court was called upon to decide whether the outsourcing of the university's cleaning, maintenance and gardening divisions amounted to a transfer of business for purposes of section 197 of the LRA. The university decided to outsource a range of non-core activities, sought to terminate the services of staff involved and invited them to seek employment with the service providers. The union primarily sought to have the contracts of employment transferred to the service providers and to have the terminations reversed. It argued that in section 197 situations, these contracts are automatically transferred and the specific outsourcing contracts constituted a section 197 transaction.\(^\text{115}\)

Mlambo J was of the view that for an automatic transfer section 197(1) should state that it is permissible to transfer employment contracts without consent (this section says the opposite) and then in section 197(2) to describe the parameters and limitations where this happens.\(^\text{116}\)

The contracts of employees affected by a transfer switch to the new employer only when the employers want them to; section 197 is there, not to ensure that the contracts of willing employees transfer, but that they will transfer without their consent if the employers so wish.\(^\text{117}\)

Mlambo J held that it is in circumstances where employees do not consent to the transfer of their employment contracts and where the business is transferred as a going concern, that section 197 provides protection.\(^\text{118}\)

Mlambo J disagreed with the decision in *Foodgro*, which held that section 197 does provide for the automatic transfer of staff. The LAC in *Foodgro* referred to the "automatic transfers" of contracts of employment that took place as a result of the transfer of a business as a going concern.\(^\text{119}\) However, Mlambo J was bound by the *Foodgro* decision as it was handed down by a superior court.\(^\text{120}\)
Mlambo J questioned the decision in *Foodgro*, but held that he was bound by the finding. He felt that section 197 will only apply when the employers agree that the contracts of employees will be transferred. In his regard, *Foodgro* took the opposite view.\(^{121}\)

The impression created by the *Foodgro* and the *Powerplus* decisions was that once it is established that there has been a transfer of a business as a going concern, it followed that the rights and obligations that existed between the old employer and the affected employees have by operation of law been transferred automatically to the new employer, who is obliged to employ those employees.\(^{122}\)

Mlambo J took issue with this view, he pointed out that section 197\(^{123}\)

> “prohibits the transfer of employment contracts without the consent of the employees concerned. The section provides, however, that employers may transfer employment contracts without the consent of the employees concerned where he transfers his business or part thereof as a going concern. In other words, the provisions of section 197 become relevant where the transfer of employment contracts without their consent is contemplated.”\(^{124}\)

Mlambo J’s view is that section 197 simply overcomes the common law problem that contracts cannot be transferred without consent, gives the buyer and seller the choice whether or not to transfer, but where the decision to transfer is made then the employees are protected under section 197 (2) and (4) in the preservation of conditions of service, unless otherwise agreed.\(^{125}\)

While recognising that outsourcing contracts could, in certain circumstances, amount to a transfer of a part of a business, the Labour Court in *University of Cape Town* held that the contracts in question did not have that effect. The test is whether, in substance, the transaction indicates a transfer of business.\(^{126}\)

The Labour Court held that, while it is possible for an outsourcing contract to be permanent and involve the transfer of assets, thus classifying it as a transfer of part of the contractor’s business, the outsourcing contracts at issue were not of that nature.\(^{127}\)

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121 Beaumont “Dramatic new case law” 137.
122 Grogan & Gauntlett “Outsourcing workers” 15 16.
123 Grogan & Gauntlett “Outsourcing workers” 16.
124 *NEHAWU v University of Cape Town & others* [2000] 7 BLLR 803 (LC) 17.
125 Beaumont “Section 197 Transactions” 324.
126 Grogan & Gauntlett “Case Roundup: Latest judgments and awards” 2000 EL 25.
127 Grogan & Gauntlett “Case Roundup: Latest judgments and awards” 26.
Mlambo J held, however, that the outsourcing did not constitute a transfer of a going concern as envisaged by section 197 and declined to grant the relief sought. Only parts of the services concerned had been outsourced and the university had retained supervisory powers. Moreover, it could not be said that the outsourcing contracts amounted to a transfer of parts of the university’s business “as a going concern”.

Whilst the university had identified non-core activities, it decided to retain certain of them as in-house and split those which were outsourced to multiple providers. Managerial and supervisory staff, particularly in the cleaning section, were retained as a control measure. In essence only some parts of the activities were outsourced. Linkages back to the university were pronounced. The contracts were not permanent; the functions were capable of being performed in-house later on.

On the facts the Labour Court found that the outsourcing did not constitute a transfer of a going concern and refused the union the relief it sought. The court accordingly refused to grant a declarator that the outsourcing would have the effect of automatically transferring the contracts of the affected university employees to the contracting companies.

The court felt that the case law on section 197 was wrong and that this section does not provide for the automatic transfer of employment. The contracting parties have a choice whether or not to effect the transfers of employment. This was a commentary or obiter and does not amount to case law.

Instead of placing emphasis on section 197(2)(a), as earlier judgments had done, Mlambo J chose to focus on the introductory words of section 197(1). By doing so, he interpreted the provision as a whole as if it dealt only with situations in which the contracts of the employees had in fact been transferred without their consent. It was only when section 197 was read in this way, said Mlambo J, that the employees were protected by the provision stipulating that the new employer would for all intents and purposes take the place of the old employer.

128 Beaumont “Dramatic new case law” 137.
129 Grogan & Gauntlett “Case Roundup: Latest judgments and awards” 26.
130 Beaumont “Section 197 Transactions” 325.
131 Beaumont “Section 197 Transactions” 323.
132 Grogan & Gauntlett “Case Roundup: Latest judgments and awards” 26.
133 Grogan “A twist on transfers” 10.
The apparently radical conclusion which Mlambo J arrived at was this:135

“Thus an employer in the process of transferring his business or part thereof has a choice whether to also transfer the contracts of employment attached to that business or not. If he decides to transfer those contracts, section 197 kicks in.”136

According to this analysis, the University of Cape Town was not obliged to transfer the contracts of employment of the affected workers to the contracting companies, as NEHAWU claimed the university was bound to do. This finding would have disposed of the matter had Mlambo J not thought that he was bound to follow the contrary view expressed by the LAC in *Foodgro*.137

3.3.3.1 **Two circumstances**

Which view is correct? Section 197(2)(a) deals with the transfer of rights and obligations from the “old” to “new” employers in the event of transfers of businesses as “going concerns”. However, section 197(2)(a) must be read with section 197(1)(a) to which it expressly refers.138 Rights and obligations only transfer automatically from one employer to the other if the business is transferred “in the circumstances referred to in subsection (1)(a)”.139

The difference between Mlambo J’s interpretation of section 197(2)(a) and that adopted in *Foodgro* and *Powerplus* turns on what circumstances are envisaged in the cross-reference to section 197(1)(a).140

When section 197 is read as a whole, it is clear that it is intended to be permissive. What circumstances did the legislature have in mind when it referred in section 197(2)(a) to section 197 (1)(a)? Two sets of circumstances are implicitly envisaged in section 197(1): first, that the contracts are transferred without the employees’ consent; second, that there is a transfer of business as a going concern. These are the circumstances that must exist before the transferring employer can rely on section 197(1)(a).141

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135 Grogan “A twist on transfers” 10.
136 *NEHAWU v University of Cape Town & others* [2000]7 BLLR 803 (LC) 21.
137 Grogan “A twist on transfers” 10.
138 Grogan & Gauntlett “Outsourcing workers” 16.
139 S197 (prior to 2002 amendments).
140 Grogan & Gauntlett “Outsourcing workers” 16.
141 Grogan & Gauntlett “Outsourcing workers” 16.
In the interpretation of section 197(2)(a), Foodgro and Powerplus place emphasis on the second circumstance; and University of Cape Town, on the first.142

Is Mlambo J’s interpretation of section 197 correct? Grogan is of the view that what he appears to have overlooked, with respect, is that the cross-reference in section 197(2)(a) is specifically to section 197(1)(a). If section 197(1)(a) is read in isolation, it refers to one condition only, namely, that “the whole or any part of a business, trade or undertaking is transferred by the old employer as a going concern”.143

If that phrase had been used in section 197(2)(a), the meaning of the latter provision would have been clear: provided that there is a transfer of the business as a going concern, the old employer’s rights and obligations in respect of its employees transfer automatically to the new employer.144

Read thus, section 197(1) and (2) fulfill distinct purposes. The former provision permits employers involved in sales, mergers and the like to transfer employees without their consent if they wish to do so when a business is transferred as a going concern. Section 197(2) ensures that, whenever a transfer of a business as a going concern occurs, the contracts of affected employees transfer as well, whether the employees like it or not. On this reading, it does not follow that, because section 197(1) permits an employer to transfer affected workers without their consent, the employer can decide not to transfer affected workers if they wish to be transferred. The ‘agreement’ referred to in section 197(2)(a) has nothing to do with the ‘consent’ mentioned in section 197(1). The proviso that the contracts of employment of the workers concerned will transfer automatically “unless otherwise agreed” is aimed at ensuring that employees who face transfer as a consequence of a sale or merger of the business of their employers can renegotiate certain terms of their contracts, as was found to be their right in Foodgro.145

3.3.3.2 Second hurdle

Although the Court in University of Cape Town disagreed with the Foodgro judgment, it noted correctly that Foodgro only assisted NEHAWU over the first hurdle. The second hurdle faced by the union was the requirement that it prove that the outsourcing arrangements, in fact, amounted

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142 Grogan & Gauntlett “Outsourcing workers” 16.
143 Grogan & Gauntlett “Outsourcing workers” 17.
144 Grogan & Gauntlett “Outsourcing workers” 17.
145 Grogan & Gauntlett “Outsourcing workers” 17.
to transfers of parts of the University of Cape Town's business as going concerns.\textsuperscript{146} This was whether the outsourcing of the University of Cape Town's gardening, cleaning and maintenance divisions amounted to a transfer of part of the university's business "as a going concern".\textsuperscript{147}

On the face of it, a company's decision to bring in an outsider to perform services previously rendered by its employees amounts to a "transfer of part of its business as a going concern". That the function so transferred is not part of the transferor's core business does not matter. However reluctantly it may perform the task, maintaining grounds and gardens is part of a university's business.\textsuperscript{148}

For the purposes of section 197, the court held that the test was whether or not the entity that was sold was an economic entity that was still in existence; this would be the case where its operation was actually being continued or had been taken over by the new employer with the same or similar activities.\textsuperscript{149}

In order to establish whether outsourcing amounts to the transfer of a business, the nature of outsourcing must be examined. According to Mlambo J, there are marked differences between outsourcing and the sale or merging of businesses. This is how he described them:\textsuperscript{150}

"Outsourcing involves the putting out to tender of certain services for a fee. The contractor performs the outsourced services and in return is paid a fee for its troubles by the employer. Where outsourcing occurs the employer pays the contractor a fee to render the services outsourced as opposed to paying salaries or wages to a group of employees to render the outsourced service. An outsourcing transaction is usually for a fixed period of time at the end of which it again goes out to tender and the existing contractor could lose the contract to another contractor."\textsuperscript{151}

Upon the sale or merger of a business, on the other hand, the business or part of the business changes hands permanently. The seller relinquishes control over the business forever. For Mlambo J, the impermanence of outsourcing contracts and the permanence of sales provides the key to why section 197 applies in respect of the former but not in respect of the latter.\textsuperscript{152} As Mlambo J pertinently asked, if section 197 were to result in the automatic transfer of the outsourced employees from the employer to the contractor, what happens if the employer

\textsuperscript{146} Grogan & Gauntlett "Outsourcing workers" 17.
\textsuperscript{147} Grogan "A twist on transfers" 10.
\textsuperscript{148} Grogan & Gauntlett "Outsourcing workers" 17.
\textsuperscript{149} Laubscher "Case Notes" 41.
\textsuperscript{150} Grogan & Gauntlett "Outsourcing workers" 18.
\textsuperscript{151} NEHAWU v University of Cape Town & others [2000] 7 BLLR 803 (LC) 30.
\textsuperscript{152} Grogan & Gauntlett "Outsourcing workers" 18.
subsequently exercises its contractual right to cancel the outsourcing contract and award it to another contractor? Section 197 clearly does not deal with such a situation.\textsuperscript{153}

It cannot be contended that the workers’ contracts transfer automatically from the one contractor to the other, because, even if the change amounts to a transfer of business from the one contractor to the other, such transfer is not effected by the “old employer”, who is, of course, now the unsuccessful contractor.\textsuperscript{154}

The only application section 197 can have in these circumstances is that to which it was put in \textit{Foodgro}: namely, to ensure that employees who lose their jobs if the contractor decides to retrench them are given severance pay calculated according to their service with the first contractor and their period of service with the original employer. According to Mlambo J, this can possibly be the case in some outsourcing arrangements, however it was not the case in the arrangement contemplated by the University of Cape Town.\textsuperscript{155} Mlambo J ruled that the outsourcing was not a transfer of part of the university’s business as a going concern, because the university had not retained control over the work to the contractors, and because the arrangement with the contractors was not permanent.\textsuperscript{156}

For Mlambo J, the most significant of all consequences was that sales and mergers involve the permanent transfer of the business or parts of businesses, while most outsourcing arrangements are not permanent. It is not the business that is transferred, but merely the opportunity to perform the outsourced service. The outsourcing party has the right to decide who gets the contract to perform the outsourced service when the original contract expires. If the outsourcer chooses another contractor, what happens to the employees who were transferred to the original sub-contractor?\textsuperscript{157}

Whether the conclusions drawn by Mlambo J in \textit{University of Cape Town} is correct can be finally decided only by the Labour Court. Employers should not jump to the conclusion that outsourcing is a complete cure when it comes to rationalisation.\textsuperscript{158} Mlambo J makes it very clear that outsourcing does not relieve the employer of the duty to treat affected employees fairly, the \textit{University of Cape Town} judgment indicates that an outsourcing arrangement will not escape the

\textsuperscript{153} Grogan & Gauntlett “Outsourcing workers” 18.
\textsuperscript{154} Grogan & Gauntlett “Outsourcing workers” 18.
\textsuperscript{155} Grogan “A twist on transfers” 10.
\textsuperscript{156} Grogan “Outsourcing services” 5.
\textsuperscript{157} Grogan & Gauntlett “Outsourcing workers” 18.
net of section 197 simply because it is called outsourcing or merely because the old employer is the only customer of the contracting company.\textsuperscript{159}

In \textit{University of Cape Town}, the university retained not only the right to review the outsourcing contracts periodically and put them out to tender again, but also retained the power to supervise and manage the manner in which the work handed out to the contractor was conducted.\textsuperscript{160} According to Mlambo J, these characteristics precluded him from finding that the outsourcing contracts amounted to a transfer of part of the university’s business. An outsourcing contract will qualify as a transfer of business as a going concern only if the employer “relinquishes the power to dictate standards over the outsourced services”.\textsuperscript{161}

The Labour Court judgment did establish one firm principle; namely, to constitute a transfer of part of a business, the outsourcing arrangement must be permanent.\textsuperscript{162}

The issue in this case was whether a “first-generation” outsourcing arrangement could attract the provisions of section 197. The Labour Court held that, because the first- or subsequent generation contractor could not possibly be bound by section 197 to transfer affected employees to the second or later, outsourcing itself did not constitute a transfer of business as a going concern.\textsuperscript{163}

The reasoning of Mlambo J in \textit{University of Cape Town (LC)} was that outsourcing cannot constitute a transfer of business because when a service is outsourced, the contractor does not gain control over the ultimate fate of the contract, control remains in the hands of the principal.\textsuperscript{164}

\textbf{3.3.4 \textit{NEHAWU v University of Cape Town & others}:\textsuperscript{165} the LAC decision}

The question whether employers who are parties to a transfer of the whole or part of businesses as going concerns can agree not to transfer the affected employees, split the LAC.\textsuperscript{166} Van Dijkhorst AJA (who wrote the majority judgment) and Comrie AJA agreed with the university’s argument that employers can decide between them not to transfer employees, whilst Zondo JP thought otherwise.\textsuperscript{167}

\textsuperscript{159} Grogan & Gauntlett “Outsourcing workers” 18.  
\textsuperscript{160} Grogan & Gauntlett “Outsourcing workers” 18.  
\textsuperscript{161} \textit{NEHAWU v University of Cape Town & others} [2000] 7 BLLR 803 (LC) 33.  
\textsuperscript{162} Grogan “Outsourcing services” 5.  
\textsuperscript{163} Grogan & Gauntlett “Second-generation outsourcing” 11.  
\textsuperscript{164} Grogan & Gauntlett “Second-generation outsourcing” 11.  
\textsuperscript{165} [2002] 4 BLLR 311 (LAC).  
\textsuperscript{166} Grogan “A twist on transfers” 10 11.  
\textsuperscript{167} Grogan “A twist on transfers” 11.
Van Dijkhorst AJA felt that the key to the correct interpretation of section 197 was its silence on whether employers who are parties to a transfer of business are required to agree to a transfer of affected employees.\(^{168}\)

The most important indication for Van Dijkhorst AJA that the legislature intended to allow employers to choose whether to transfer employees along with businesses lies in the concept of “business as a going concern”.\(^{169}\) The judge wrote:

“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 an undertaking, the attainment of its goals). In every business its employees are a vital component and in labour intensive industries the major asset. To say that there can be a sale of business as a going concern without all or most of the employees going over is to equate a bleached skeleton with a vibrant horse. A going concern is ‘one in actual operation … That cannot be the case where there is no workforce.’\(^{170}\)

The purchasers and sellers of businesses “as going concerns” are free to define what is included in that concept. This interpretation of “going concern” enables the employers to ensure that their transaction escapes the provisions of section 197 by simply agreeing not to include all or most of the employees of the transferor. Where they do so, the transaction does not amount to a “transfer of a business as a going concern”, it is a “bleached skeleton, not a vibrant horse” and the people who gave life to the “horse” have no say in the matter (their exclusion from the transaction renders it immune by definition from the reach of section 197).\(^{171}\) Where the seller and the purchaser agree that the employees are not part of the transaction, the transaction does not amount to a transfer as a going concern and the provisions of section 197 do not apply.\(^{172}\)

For the majority, this conclusion was the end of the inquiry. The University of Cape Town and the respondent contractors were legally entitled to agree that the university’s garden, cleaning and maintenance workers could choose between applying for posts with the contractors or being retrenched by the university.\(^{173}\) That meant that the outsourcing arrangements did not amount to a transfer of part of the university’s business as a going concern and thus NEHAWU’S appeal had to fail.\(^{174}\)

\(^{168}\) Grogan “A twist on transfers” 11.
\(^{169}\) Grogan “A twist on transfers” 11.
\(^{170}\) NEHAWU v University of Cape Town & others [2002] 4 BLLR 311 (LAC) 104.
\(^{171}\) Grogan “A twist on transfers” 11.
\(^{172}\) Laubscher “Case Notes” 41.
\(^{173}\) Grogan “A twist on transfers” 11.
\(^{174}\) Grogan “A twist on transfers” 11.
It was the term “going concern” that led Van Dijkhorst AJA to conclude that the transfer of a business without its staff did not attract the provisions of section 197. A “going concern” must, in the opinion of the majority, include the employees. Zondo JP (who wrote the minority judgment) did not agree that the transfer of a business without its employees cannot in any circumstances amount to the transfer of a business as a going concern. Zondo JP pointed out that the question whether a business has been transferred as going concern is a matter for objective determination on the facts of each case.

Zondo JP set out a number of factors relevant in determining whether a business has been transferred as a going concern and stated that the decisive criterion for establishing the existence of a going-concern transfer is whether the entity in question retains its identity.

Zondo JP reasoned that if a business can be deemed to be transferred as a going concern even without its employees, it follows that the mere fact that the employers agree the employees of the transferors will not be transferred, is not in itself sufficient to render the transaction something other than the transfer of a business as a going concern.

The majority of the three-judge bench decided that the legislature intended primarily to protect employees against forced transfers and to facilitate business transfers, but held that even on its interpretation, section 197 “is not without advantage to employees”, without specifying what those advantages are.

However, Zondo JP, following the judges in Foodgro, held that the purpose is to protect employees from losing their jobs when their employers’ businesses change hands. There can be little doubt that Zondo JP’s assessment of the purpose of section 197 is correct. The idea that the legislature intended only to protect the right of employees not to be transferred without their consent is far-fetched. Since that right is in any event entrenched in the common law, there was no need to enact a special statutory provision to protect it. However, a statute can only be applied in the manner in which it is intended to be applied, if its words allow it to be so applied.
The majority of the LAC held that *Foodgro* had been incorrectly interpreted and that section 197 transfers of employment only arise where two employers agree that the contracts of employment will be transferred. The LAC’s finding included:\textsuperscript{184}

- The alteration of the common law on a consensual transfer of employment is more onerous than common law. The statute did not intend to burden the purchaser further.
- It is correct that the status quo benefits under section 197 secure advantages for employees not previously enjoyed, if intended to mean that automatic transfers occur not only in case of consensus then no reasons given.
- It is correct that employees transferred under section 197 can resign.
- It is also correct that new employees are subject to additional sanctions/remedies because of transfers of employment.

The majority of the LAC held that the decision in *Foodgro* does not stand in the way of a finding that section 197(1) is to be interpreted to limit its scope to the situation where the seller and the purchaser define the transaction as the sale of a business as a going concern (employees included). The LAC held that Mlambo J in the Labour Court was correct that the consensual transfer of contracts of employment is a prerequisite for its operation.\textsuperscript{185}

The LAC held that a transfer of a going concern is a subjective test dependent upon the agreement of the old and new employers.\textsuperscript{186}

The LAC did not address the question whether an outsourcing contract could be a transfer of a going concern.\textsuperscript{187} Given the terms on which this matter was argued and decided, there was no need for the court to decide on the second issue raised by the judgment of the court a quo, namely, whether the outsourcing arrangements entered into by the university amounted to transfers of parts of its business as going concerns.\textsuperscript{188}

The effect of this matter under the original section 197 was that employers who wished to dispense with and acquire businesses are free to agree that the transferor’s employees will not be taken into employment by the transferee, and to arrange the terms of the transfer accordingly. However, the

\textsuperscript{184} Beaumont “Dramatic new case law” 138.
\textsuperscript{185} Beaumont “Dramatic new case law” 139.
\textsuperscript{187} Beaumont “Dramatic new case law” 139.
\textsuperscript{188} Grogan “A twist on transfers” 14.
old employer will then have to retrench its employees in accordance with the provisions of section 189 of the LRA.\textsuperscript{189}

This judgment was handed down on the eve of the replacement of section 197 by a wholly revised provision that leaves no doubt about the legislature’s intention to deprive employers of the right to decide whether employees will retain their jobs when businesses are transferred. A court cannot have regard to a pending amendment when interpreting an existing statutory provision, but it is worth asking whether the majority’s interpretation of the original section 197 would survive the amendment.\textsuperscript{190}

\textbf{3.3.5 NEHAWU v University of Cape Town & others:}\textsuperscript{191} the Constitutional Court decision

The Constitutional Court (CC) upheld the view of the minority and overruled the majority judgment.\textsuperscript{192} The CC held that the original section 197 resulted in the automatic transfer of the old employer’s contracts of employment, a ruling confirmed by the new section 197 [See Chapter 4].\textsuperscript{193}

The purpose behind section 197 prior to the amendments was debated and defined in this Constitutional Court (CC) matter. This finding is important in assisting all stakeholders in understanding the intention behind section 197 and the balance that it offers to both employers and employees.\textsuperscript{194}

Section 197 offers assistance to both employers and employees by amending some of the consequences which otherwise would have occurred through the common law. Without section 197, employees could resist being transferred to a new employer and potentially could hold the seller to ransom over a potential transfer of a going concern.\textsuperscript{195}

\textsuperscript{189} Grogan “A twist on transfers” 14.
\textsuperscript{190} Grogan “A twist on transfers” 14.
\textsuperscript{191} 2003 (3) SA 1 (CC).
\textsuperscript{192} Grogan “Outsourcing services” 4.
\textsuperscript{193} Grogan \textit{Dismissal} 413.
\textsuperscript{194} Beaumont “The real purpose behind section 197” 343.
\textsuperscript{195} Beaumont “The real purpose behind section 197” 346.
Section 197 has a dual purpose – facilitating commercial transactions and protecting workers against unfair job losses.\textsuperscript{196} Properly construed section 197 was for benefit of both employers and workers.\textsuperscript{197}

According to the CC, the construction placed on section 197 by the majority judges in \textit{NEHAWU v University of Cape Town (LAC)}, erred in two respects:

- the first error was to misrepresent the meaning of going concerns; and
- the second was to ignore the legislature’s intention to protect jobs.\textsuperscript{198}

Ngcobo J considered the meaning of the phrase “going concern” and held that it should be given its ordinary meaning, which is a “business in operation so that the business remains the same but in different hands”.\textsuperscript{199}

Whether a business is transferred depends on substance and not form; this is an objective test determined in light of the facts of each transaction. The CC thus found the LAC was incorrect in its interpretation of section 197, even though there was no agreement between the university and the outsource service providers to take over staff, this did not prevent the labour court from enquiring into and making a finding whether outsourcing was a transfer of a going concern.\textsuperscript{200} Each transaction must be considered on its own merits and regard must be had to substance rather than form.\textsuperscript{201}

The CC did not deem it necessary to discuss the phrase “transfer of business as a going concern”, and the judgment leaves the labour courts free to apply that concept on a case by case basis, subject only to the proviso that a court cannot rule that a business is not transferred as a going concern solely because the employers have agreed not to transfer the affected employees.\textsuperscript{202}

The CC found it unnecessary to deal with the outsourcing issue, as this entailed questions, which the LAC had not considered and the matter was remitted to the LAC for decision on that point.\textsuperscript{203} It therefore remains possible that the LAC may still find that the outsourcing arrangement entailed

\textsuperscript{196} Beaumont “The real purpose behind section 197” 346; \textit{NEHAWU v University of Cape Town & others} 2003 (3) SA 1 (CC) 53.

\textsuperscript{197} Schulze “The Law Reports” 2003 \textit{De Rebus} 47 48.

\textsuperscript{198} Grogan & Gauntlett “Going Concerns” Feb 2003 \textit{EL} 18 20.

\textsuperscript{199} Laubscher “Case Notes” 42.

\textsuperscript{200} Beaumont “The real purpose behind section 197” 347.

\textsuperscript{201} Laubscher “Case Notes” 42.

\textsuperscript{202} Grogan & Gauntlett “Going Concerns” 21.

\textsuperscript{203} Grogan & Gauntlett “Going Concerns” 21.
only the transfer of the “bleached skeleton” of the university’s gardening, cleaning and maintenance division.  

If the LAC overrules Mlambo J’s ruling that the outsourcing arrangement did not constitute a transfer of parts of the business of the university as a going concern, the sub-contractors will be obliged to take on the retrenched university employees. But if for any reason the LAC upholds the Labour Court judgment, the matter could well come before the CC again.

Unfortunately for the development of our law, the parties decided to settle the matter without returning to court. In any event, that issue would have been academic, because soon after the CC laid down the true meaning of the original section 197, the legislature stepped in and tried to clarify its intention with a new version of that provision. The new version confirmed the view of Zondo JP in the minority judgment of the *University of Cape Town (LAC)* matter and the CC, namely that section 197 was intended to give blanket protection to employees whose employers transfer a whole or part of their businesses as going concerns.

Another issue which lay at the heart of the *University of Cape Town* dispute remained unresolved, namely, whether outsourcing constitutes a transfer of business as a going concern.

### 3.4 THE AMENDMENT TO SECTION 197 OF THE LRA

The original section 197 was described as a “legal monstrosity”. It was a section that gave rise to a great deal of uncertainty in that the answers to crucial questions relating to its applicability and its consequences were not discernable in its provisions.

It was anticipated that the amended section 197 would resolve the dispute over the extent of protection enjoyed by workers whose employers’ businesses are sold or absorbed by another company.

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204 Grogan & Gauntlett “Going Concerns” 22.
205 Grogan & Gauntlett “Going Concerns” 22.
206 Grogan “Outsourcing services” 4.
208 Grogan & Gauntlett “Welcome changes” 3.
According to the Labour Relations Act Amendment Bill, if a transfer of the whole or part of a business as a going concern takes place, the new employer is “automatically substituted for the old employer in respect of all contracts of employment in existence immediately before the date of transfer” and – to remove all possible doubt – “all the rights and obligations between the old employer and each employee at the time of the transfer continue in force as if they had been rights and obligations between the new employer and each employee.”

Given the changes to section 197, operative in 2002, the courts may find the latitude to deviate from the *University of Cape Town (LAC)* decision and determine that section 197 is triggered not by consensus but rather automatically where the rump of a business is transferred.

In a departure from the original section 197, the new employer in the transfer of a going concern inherits the collective dynamics of the old employer including recognition agreements, arbitration awards and extension of bargaining council agreements.

Mergers and acquisitions in so far as they relate to people involved in transfers of going concerns are covered in the amended section 197 and two new back-to-back provisions, section 197A & B. Transfers of going concerns are dealt with in section 197; and section 197A deals with the transfer of going concerns out of liquidations or insolvencies. Section 197B deals with disclosure over pending financial difficulties and insolvencies.

The amendments have shied away from defining what constitutes a transfer of a going concern. It seems still to be an objective test and that the LAC decision in *NEHAWU v University of Cape Town* will not be applicable after its promulgation.

Whilst each transaction is to be examined on its merits, a transfer of a going concern can be distinguished from a purchase of assets and most subcontracting exercises, characteristics of a transfer of going concerns will be the acquisition of brand names, people and business
A proper section 197 transaction results in the buyer or new employer inheriting all the employees in the transferred concern. Careful attention must be paid to the due diligence phase around section 197 transactions as the new employer inherits all those involved in the going concern immediately prior to the transfer on existing service contracts and human resources history together with related collectivism. Problematic areas of the amendments include the elaborateness of the new section 197 and section 197A transfers including the omission to define what constitutes a going concern. The retention of the phrase “as going concerns” in the amended section 197 leaves the issue regarding whether outsourcing arrangements amount to transfers of part of businesses as going concerns, open for debate after the amendment comes into force.

218 Beaumont “Labour Law Changes” 149.
221 Grogan “A twist on transfers” 14.
CHAPTER 4
THE “NEW” SECTION 197

4.1 INTRODUCTION

The legislature drastically amended the law relating to the position of workers whose employers transfer their businesses. The amended section is far more detailed than the original and it separates transfer in the ordinary course of business activities from transfers on insolvency.

The content of section 197 changed with the 2002 amendments. Its interpretation and application have been clarified as a result. Employees now automatically follow a transfer of a going concern by becoming employees of the “buyer.”

The new section 197 is far more comprehensive than its predecessor in that it sets out more clearly what the consequences are should the section be found to apply.

4.2 AN ANALYSIS OF THE NEW SECTION 197

Section 197 of the LRA was substituted by section 49 of the Labour Relations Amendment Act and section 197(1) now reads as follows:

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

Section 197(2) reads:

“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;

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222 Grogan & Gauntlett “The new law on retrenchment – Practical effects of the amendments to section 189 and 197” 2002 EL 4. [Hereinafter referred to as “The new law on retrenchment.”]
223 Wallis 9.
224 Beaumont “The real purpose behind section 197” 343.
(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.

The effect of these provisions is that the old employer is not required to seek the employees’ consent before their contracts are transferred; neither does the old employer have to retrench them. The employment contracts migrate automatically and no dismissals are deemed to have occurred.\(^{227}\)

The right of employees to have their contracts transferred is dependent on the transfer of a business meeting the exact wording of section 197, namely if “the whole or part of a business, trade, undertaking or service” is transferred by the old employer “as a going concern”.\(^ {228}\)

The new section 197 (regulating transfers of solvent businesses) and section 197A (regulating transfers of insolvent businesses) also protect jobs far more effectively than their poorly worded predecessor in situations that might otherwise give rise to retrenchment. The original section 197 was held, just before its demise, to leave intact the choice of employers who are party to sales, mergers or other forms of transfers of business to decide whether the new employer will also take over the employees of the transferor (see *NEHAWU v University of Cape Town*\(^ {229}\)). The new section 197 and 197A leave no doubt that employers who are party to transfers of businesses are deprived of that choice.\(^ {230}\)

It is clear that the new sections 197 and 197A are intended to clarify the meaning of their predecessor. But do they?\(^ {231}\) The new section 197 removes most of the ambiguities of its poorly drafted predecessor; it clearly states that when a business is transferred as a going concern “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”, unless the


\(^{228}\) Basson et al *Essential Labour Law* 174.

\(^{229}\) [2002] 4 BLLR 311 (LAC).

\(^{230}\) Grogan & Gauntlett “The new law on retrenchment” 8.

\(^{231}\) Grogan & Gauntlett “Going Concerns” 20.
employers agree otherwise with the employees or their representatives.\textsuperscript{232} This makes it clear that the old employer and the new employer cannot agree without the affected employees' consent that the employees will not be transferred.\textsuperscript{233}

The amendment places beyond all doubt the lawmaker's desire to ensure that, when businesses are transferred as going concerns, affected employees retain their jobs with the new employer irrespective of the wishes of the employers.\textsuperscript{234}

A transfer of contract of employment arises under section 197 where a business is transferred as a going concern, in which event the receiving employer (the buyer) automatically inherits the employees on existing terms and conditions of employment.\textsuperscript{235}

A contractual link between the transferor and the transferee is not a necessary precondition for the application of section 197.\textsuperscript{236}

Section 197 is triggered where a business or any part thereof is transferred as a going concern. A business here includes any business, trade, undertaking or service. The word service was introduced in 2002 along with other amendments to the section. Neither of the words business or going concern are defined.\textsuperscript{237} These amendments further removed uncertainty as to the for section 197; this section kicks in where there is a transfer of a going concern and the new employer then automatically steps into the shoes of the old employer and inherits the existing staff on current employment terms.\textsuperscript{238}

There are three components behind the application of section 197:

- a business
- as a going concern
- is transferred.\textsuperscript{239}

\begin{flushright}
\textsuperscript{232} Grogan & Gauntlett “Going Concerns” 20 21. \\
\textsuperscript{233} Grogan & Gauntlett “Going Concerns” 21. \\
\textsuperscript{234} Grogan & Gauntlett “Going Concerns” 20. \\
\textsuperscript{235} Beaumont “Business transfers” 135. \\
\textsuperscript{236} Grogan & Gauntlett “Case Roundup: Double transfer” 19 20. \\
\textsuperscript{237} Beaumont “Coping with corporate re-organisation: Outsourcing is dead: Long live outsourcing: 2005 Beaumonts Service Beaumont Express 50. [Thereinafter referred to “Outsourcing is dead”.] \\
\textsuperscript{238} Beaumont “Outsourcing is dead” 50. \\
\textsuperscript{239} Beaumont “Outsourcing is dead” 51.
\end{flushright}
Our courts are reluctant to provide an exhaustive definition of these terms. Organisations and
business structures vary enormously and all relevant factors need to be considered and evaluated
as a whole.240

The terms business, including a service, and a going concern, conjures up the notion of continuity.
Some items are so innate or free standing that their transfer breaks this continuity and, therefore,
can never fall within section 197. To this extent the terms are interrelated but are separate.241

These phrases are crucial, because if the entity transferred is not a business or part thereof, or if it
is not transferred “as a going concern”, the main consequences of section 197, namely, the
transfer of the contracts of employment of the old employer to the new employer, do not occur by
operation of law.242

4.2.1 “Going concern”

The only question left open by the new section 197 and 197A is when the transfer of the whole or
part of a business constitutes a transfer of a business “as a going concern”. It seems clear,
however, that the ruling by the majority of the LAC in the University of Cape Town case that the
transfer of a business without its employees cannot be deemed a transfer of that business as a
going concern does survive the amendment. Otherwise, employers will be able to prevent the
“automatic” transfers of employees by simply not including them in the transfer; to allow them to do
so would deprive the amendment of all force.243

The new section 197 spells out the rights and obligations of the various stakeholders once a
business is transferred as a going concern. It does not however define what constitutes a going
concern.244

The new section 197 still applies only when a business is “transferred as a going concern” and that
troublesome phrase is not clarified.245 A practical requirement must be satisfied before section
197 kicks in: the employer must have concluded a transfer agreement, and the relevant business,
part of a business or service must actually have been transferred.246

240 Beaumont “Outsourcing is dead” 51.
241 Beaumont “Outsourcing is dead” 51.
242 Grogan Dismissal 410.
244 Beaumont “The real purpose behind section 197” 344.
245 Grogan & Gauntlett “Going Concerns” 21.
246 Grogan “Outsourcing services” 10 11.
The notion of “transfer of business as a going concern” is central to the provision, which seeks to protect those employees whose jobs are jeopardised by the sale or merger of the business of their employer to or with another entity.247

The CC in the University of Cape Town dispute held that the test is an objective test (thus not dependent on the desires of the parties involved in the transfer) and one, which has regard to substance and not form. The question is whether there is the transfer of a business in operation “so that the business remains the same, but in different hands”.248

Substance will prevail over form: which means that the intrinsic characteristics of the transaction are assessed and not simply the title or label, which the contracting parties have given to their transaction.249 To determine whether the business has been transferred as a ‘going concern’ would require an examination of the substance and not the form of the transfer; weighing factors that are indicative of a section 197 transfer against those which are not; treating previous cases as useful indicators, but not precedent; and in this way deciding what is ultimately a question of fact and degree.250 Whether a particular transaction can be construed as a section 197 event must be interpreted on the substance and not form of the transaction.251

Dijkhorst AJA in NEHAWU v University of Cape Town252 recited the ordinary definitions of a going concern; one in actual operation; a business already in operation (which cannot occur in the absence of the workforce) or an existing business operating in its ordinary and regular manner. A going concern can only arise where all or a material part of the workforce are/is included. No take-on of employees, no going concern.253

“To 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.”254

Determining whether a transfer of a business amounts to a transfer “as a going concern” is, in short, an issue that must be decided on the facts of each case.255

247 Grogan & Gauntlett “Second-generation outsourcing” 10.
248 Bosch “Of business parts and human stock” 1865.
249 Beaumont “Outsourcing” 558.
250 Olivier & Smit 83.
251 Beaumont “Section 197 Transactions” 322.
253 Beaumont “Dramatic new case law” 137.
254 NEHAWU v University of Cape Town & others [2002] 4 BLLR 311 (LAC) 104.
255 Grogan “A twist on transfers” 12 13.
4.2.2 “Business, trade, undertaking, or service”

Grogan is of the view that the “definition” of business in section 197(1)(a) is tautological; its main purpose seems to be to emphasize that section 197 applies not only to the transfer of entire businesses, but also to parts of businesses.\textsuperscript{256}

Section 197 will only apply when what is transferred is a “business”.\textsuperscript{257} In terms of section 197(1)(a) a “business” includes the “whole or a part of any business, trade, undertaking or service”.

What do the expressions ‘business’ and ‘as a going concern’ relate to? It is clear that in the modern-day sense of the word a business would comprise not only tangible and intangible assets, but also intellectual property assets.\textsuperscript{258}

It is relatively easy to determine when the whole of a business, trade, undertaking or service is transferred, but problems arise in determining what is a part of a business, trade, undertaking or service for the purposes of the application of section 197.\textsuperscript{259}

A business is a going concern only if its assets, movable and immovable, tangible or intangible, are utilised in the production of profit.\textsuperscript{260}

The term “business” found in section 197 includes any business, trade, undertaking or service. Extending the net to include service is unique to South Africa and accordingly, overseas case law will not be of assistance.\textsuperscript{261}

A service is seemingly based around people, whereas a business, trade or undertaking will typically have some infrastructure in addition to people. When read with the words as a going concern, there must be some entity which is transferred. Does a group of people gathered together in a function constitute an entity?\textsuperscript{262}

\textsuperscript{256} Grogan Dismissal 410.
\textsuperscript{257} Bosch “Of business parts and human stock” 1866.
\textsuperscript{258} Olivier & Smit 83.
\textsuperscript{259} Bosch “Of business parts and human stock” 1866.
\textsuperscript{260} Beaumont “Dramatic new case law” 136.
\textsuperscript{261} Beaumont “Outsourcing is dead” 53.
\textsuperscript{262} Beaumont “Outsourcing is dead” 53.
According to the general principles of statutory interpretation, the legislature must have intended to convey something when it varies or supplements the words of a statute, but precisely what the addition of “service” meant was not initially clear.  

Grogan points out that at a semantic level, the term business includes “the whole or a part of any business, trade, undertaking or service”. Why the legislature thought it necessary to include the words “trade” and “undertaking” is not altogether clear. Both are in their ordinary meaning in any event “businesses” – in their context, “businesses”, “trades”, and “undertakings” are all broadly speaking synonymous. If the word “service” is read in the light of the preceding words, it may refer to the kind of business that renders a service to its clients, customers, or community; and that concept would not include a division within the larger business, like gardening or security, even if they also render services to the corporate goal.

Problems arise where business, rather than the legal entity that owns the business, changes hands. Where the legal entity changes hands, no difficulty arises insofar as the employees are concerned because they continue with their employment as before. But where the business changes hands, the employees, in the absence of a statutory provision, remain behind unless the new employer chooses to employ them.

Bosch advocates that, “the correct approach to determining whether section 197 will apply to a particular situation is to examine what the transferor is to be divested of as a result of the transfer and assess whether that can properly be considered a ‘business’. That entity will then be compared with what ends up in the hands of the transferee in order to establish whether the business has been transferred as a going concern, that is whether it is substantially the same business but in different hands.”

Du Toit et al submit that the test in respect of a “service” or “part of a service”, as in the case of a “business” or “part of a business” other than a “service”, is whether the activity being transferred amounts to “an organized grouping of resources which has the objective of pursuing an economic activity.”

263 Grogan “Outsourcing services” 5.
264 Grogan Dismissal 411 412.
265 Wallis 4.
266 Bosch “Of business parts and human stock” 1868.
267 Du Toit et al Labour Relations Law 452.
4.2.3 “Transfer”

The key words are a transfer of a going concern. Notably, wording such as sale of a going concern is not used. What falls within the context of a transfer is broader than a purchase and sale, but not always easy to identify.²⁶⁸

In Schutte v Powerplus Performance (Pty) Ltd²⁶⁹ the Labour Court accepted that “transfer” of a business refers only to sale but may include “merger, take-over or … part of a broader process of restructuring within a company or group of companies. Transfer can take place by virtue of an exchange of assets or a donation”.²⁷⁰

The transaction must be consummated or carried through to completion for there to be a transfer. Talks about a deal which are later abandoned do not amount to a transfer. The transfer is likely to be recorded in a written form, although this is not essential. Decisively has the entity in question retained its identity? Was there an economic entity and is this still in existence?²⁷¹

The more important question is: when has a transfer as a going concern occurred? The term ‘transfer’ should not be restricted to the sale of a business, but includes a merger, takeover or restructuring within a company or group of companies as well.²⁷²

The Labour Court in Ndima v Waverley Blankets Ltd²⁷³ made the following points:

- there is a distinction between the transfer to a business as a going concern and the physical transfer of assets. In the former case the business remains the same business but in different hands. In the latter case the assets are transferred to the new owner to be used in whatever business he may choose
- the transfer of a business and the transfer of possession and control of a business are different concepts
- whilst in reality the sale of shares in a company is used not only to gain control but also in effect the business itself, the purchase of shares in a company does not necessarily mean the buyer is going to continue the same business.²⁷⁴

²⁶⁸ Beaumont “Outsourcing” 556.
²⁶⁹ [1999] 2 BLLR 169 (LC).
²⁷⁰ Du Toit et al Labour Relations Law 448.
²⁷¹ Beaumont “Outsourcing is dead” 51.
²⁷² Olivier & Smit 83.
²⁷⁴ Beaumont “To the brink and back again” 59.
The mere transfer of administrative functions would probably not constitute a transfer for purposes of section 197, as business-like activities are not involved.\textsuperscript{275}

The transfer of a business as a going concern, may include the increasingly common practice of “outsourcing” or “contracting-out” various services which previously formed part of the business.\textsuperscript{276}

Transfers of business as a going concern may take many forms. One of the most problematic is “outsourcing” [Chapter 5 below].\textsuperscript{277}

4.2.4 \textbf{Factors in favour of the transfer as a going concern}

What is or is not a transfer of a business as a going concern is both important and difficult to determine. There is generally speaking no single test save perhaps where the old and the new employer specifically agree that there is a transfer of a going concern and where the central characteristics thereof are present.\textsuperscript{278}

These factors will include what will happen to the goodwill of the business, the stock-in-trade, the premises of the business, contracts with clients or customers, the workforce, the assets of the business and, if so, whether there has been an interruption of the operation of the business, and if so, the duration thereof, whether same or similar activities are continued after the transfer or not and others.\textsuperscript{279}

These include, for example:\textsuperscript{280}

- VAT not payable because the transaction is a sale as a going concern
- Customers transferred
- Debtors collected by new employer
- Business keeps its identity
- Same or similar activities continue
- Majority or significant number of employees transferred or invited to transfer
- Taking over of building or premises

\begin{thebibliography}{99}
\bibitem{275} Olivier & Smit 83.
\bibitem{276} Du Toit “Other basic rights relevant to labour: Socio-economic rights” 2004 \textit{Bill of Rights Compendium} 4B35. [Hereinafter referred to as “Other basic rights relevant to labour”.]
\bibitem{277} Grogan & Gauntlett “Second-generation outsourcing” 10.
\bibitem{278} Beaumont “Outsourcing” 558.
\bibitem{279} Beaumont “Outsourcing is dead” 51.
\bibitem{280} Beaumont “Outsourcing” 559.
\end{thebibliography}
Obtaining movable property such as stock

Distinguishing features of transfers of going concerns i.e. within section 197:\footnote{Beaumont “Section 197 Transactions” 325.}

- Operation continues
- Upfront consideration
- Control transferred
- Staff transferred
- Capacity/assets transferred
- Permanent/long-term transfer
- Reversion/buy-back difficult or complex
- Single transferee

Zondo JP in \textit{NEHAWU v University of Cape Town}\footnote{[2002] 4 BLLR 311 (LAC).} held that apart from the fate of the workforce of the transferor, other relevant considerations are what happens to the goodwill of the business, stock-in-trade, premises, existing contracts, assets and debts, and whether the same or similar activities are continued after the transfer.\footnote{Grogan “A twist on transfers” 12.}

What constitutes a transfer of a going concern is not defined, the Constitutional Court (CC) in \textit{NEHWAU v University of Cape Town}\footnote{2003 (3) SA 1 (CC).} (as \textit{obiter}) suggested that the following will be relevant:

- have assets, tangible or intangible, been transferred
- whether or not workers are taken over
- whether customers are transferred
- whether or not the same business will be conducted by the buyer or new employer?\footnote{Beaumont “The real purpose behind section 197” 347.}

This is not a closed list and no single factor is supposedly decisive. What a court is required to do is to examine the entity being transferred prior to transfer and then assess it after the transfer to ascertain whether it remains the same business, but in different hands.\footnote{Bosch “Of business parts and human stock” 1866.}

The results of the application of the test for transfer of a going concern are going to depend to a large extent on the circumstances of the particular case, but there is no reason why the test cannot be applied consistently whether to business sales, or initial or subsequent contracting-out.\footnote{Bosch “\textit{Aluta continua}” 94.}
Given that a “transfer” may arise from transactions other than sale, the imposition of formal criteria based on the analogy of purchase and sale is unfounded. 288

4.2.5 Factors that may not lead to a transfer as a going concern

These would involve the mere transfer or disposal of assets, a significant interruption in supply, the absorption of the business transferred into alternative existing capacity and no price or consideration made for the transfer. However, the closure of an operation will not always result in a transaction outside the scope of section 197. 289

An item of equipment, being a means of production, is not likely to amount to a business and standing alone can hardly be described as a going concern. The disposal of plant and equipment individually or in a break-up fashion will fall outside of section 197. 290

In NUMSA obo Phiri & others / Rising Sun Field Services & another291 it was held that the purchase of plant and equipment from a company that was closing down was nothing more than a commercial contract and not a section 197 transaction. 292

4.3 CASE LAW RELATING TO THE NEW SECTION 197

4.3.1 SAMWU & Others v Rand Airport Management Company (Pty) Ltd & others:293

Labour Court decision

The addition of the word “service” was first considered by the Labour Court in this matter. According Landman J, the addition of the word “service” to the definition of “business” did not significantly alter the reach of section 197 because, like any other component of a business, a service can be described as a part of a business only if it is “an identifiable component or unit of a business, be it a division, a branch, a department, a store or a production unit”; it must be

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289 Beaumont “Outsourcing” 560.
290 Beaumont “Outsourcing is dead” 51.
291 [2005] 5 BALR 519 (MEIBC).
293 [2002] 12 BLLR 1220 (LC).
“severable from the entire business” before it can be regarded as part of that business for purposes of section 197.\textsuperscript{294}

The purpose of the addition of the word “service”, was, in Landman J’s view, to clarify “the position that a business, to use a general term, may consist mainly or only of the rendering of services to another or other persons for profit or otherwise”.\textsuperscript{295} The meaning of “service” remained a question of law. Only once that meaning has been determined does the question arise: can it be said on the basis of the facts that the unit constitutes a part of the employer’s business?\textsuperscript{296}

The Labour Court held that the only question for decision was whether the outsourcing of the gardens and security divisions constituted a transfer of the company’s business as “going concerns”. The court noted that in the University of Cape Town (LAC) matter, the LAC had held that a business is transferred as a going concern only if its movable and immovable assets and the bulk of its employees are also transferred.\textsuperscript{297} That ruling, said the Labour Court in the Rand Airport case, had not been affected by the subsequent amendment to section 197 of the LRA. The Labour Court was accordingly bound by the University of Cape Town judgment.\textsuperscript{298}

The court admitted to having

“some difficulty in conceiving that a support function, as necessary as it may be, ordinarily constitutes a business or part of a business. This is not to say that 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 its own merits”.\textsuperscript{299}

A support function cannot of course constitute a business in itself, however, Landman J was not prepared to rule out the possibility that it could nevertheless be part of a business, but he was prepared to accept that everything depended on the facts of each case.\textsuperscript{300}

The Rand Airport Management Company’s business involved the provision of an airport and services related to the aviation industry. The company’s cleaning and security services, though essential, were not core functions. The company had not yet concluded an outsourcing agreement with the security contractor. It was accordingly undesirable to rule on that issue. The gardening division was not a recognisable entity. Its transfer did not therefore constitute the

\textsuperscript{294} SAMWU & others v Rand Airport Management Company (Pty) Ltd & others [2002] 12 BLLR 1220 (LC) 19.
\textsuperscript{295} SAMWU & others v Rand Airport Management Company (Pty) Ltd & others [2002] 12 BLLR 1220 (LC) 19.
\textsuperscript{296} Grogan “Outsourcing services” 6.
\textsuperscript{297} Grogan & Gauntlett “Case Roundup: No transfer” 2002 EL 24.
\textsuperscript{298} Grogan & Gauntlett “Case Roundup: No transfer” 24 25.
\textsuperscript{299} SAMWU & others v Rand Airport Management Company (Pty) Ltd & others [2002] 12 BLLR 1220 (LC) 24.
\textsuperscript{300} Grogan “Outsourcing services” 6.
transfer of a business as a going concern. The gardening division was merely “an activity” and would remain an activity in the hands of the sub-contractor. The same was true of the security and the cleaning divisions.

The court thus found that the gardening services were not part of a business for the purposes of section 197 and the section would not apply to the transaction in question.

The Labour Court was bound by the University of Cape Town (LAC) decision to the effect that section 197 only applied where the contracting parties so agreed. However, the CC in University of Cape Town case, subsequently overruled this decision in holding that section 197 applied on the merits of the transaction and was not dependent upon the intention of the parties.

4.3.2 NUMSA v Staman Automatic CC & another

The second opportunity for the court to express itself on what is a “part” of a business for the purposes of section 197 arose in this matter.

Staman Automatic CC concluded an agreement with the second respondent, a temporary employment service (or otherwise known as a “labour broker”), in terms of which the business of Staman would purportedly be outsourced to the latter, that is, the labour broker would simply take over Staman’s wage rated employees and “hire” them back to the company for a set fee. Staman argued that the services of the employees concerned would automatically transfer to the temporary employment service because the outsourcing constituted a transfer of part of its business as a going concern.

The employer and the labour broker agreed that the workers worked in a “service” which formed part of the employer’s business and would be transferred (along with the employees) as a going concern.

301 Grogan & Gauntlett “Case Roundup: No transfer” 25.
302 Grogan “Outsourcing services” 6.
303 Bosch “Of business parts and human stock” 1867.
304 Beaumont “Outsourcing is dead” 50.
306 Bosch “Of business parts and human stock” 1867.
308 Grogan “Outsourcing services” 13.
309 Grogan “Case Roundup: Not transfers” 20.
310 Bosch “Of business parts and human stock” 1868.
Unlike normal outsourcing arrangements, the workers concerned constituted the bulk of the workforce and performed key functions in the manufacturing process (they were not “non-core” employees).\textsuperscript{311}

The Labour Court noted that the amended section 197 defines “business” as “the whole or part of any business, trade, undertaking, or service”. Whether the transfer of a number of employees could constitute a transfer of business was the critical issue.\textsuperscript{312}

The court held that when applying section 197, the question was whether a business, trade, undertaking or service has been transferred and, if so, whether it has been transferred as a going concern.\textsuperscript{313}

The court found that there was no “service” that could be transferred in terms of section 197.\textsuperscript{314}

It does not follow that a group of employees who render service to an employer constitute an economic entity capable of being transferred within the meaning of section 197.\textsuperscript{315} Their work was connected to their machines, which had not been transferred, thus, the workers could not possibly be described as an entity that would retain an economic identity after the purported transfer.\textsuperscript{316}

The court’s approach was to examine what was to be transferred and assess whether that amounted to a “business”. \textit{In casu}, the employees purported to be engaged in the transfer of part of the transferor’s business, whereas in reality all that was being transferred was the transferor’s employees or, more specifically, their services. Those could not on their own, constitute part of a business for the purposes of section 197.\textsuperscript{317}

Bosch points out that the reason set out by the court, namely, that the services of the employees did not constitute an economic entity that would retain its identity after the purported transfer, is relevant to the enquiry whether a business has been transferred as a going concern and not whether the subject-matter of a transfer constitutes a business. It only becomes relevant once the court has established what the relevant “business” is. That is, having found that there was a

\textsuperscript{311} Grogan “Outsourcing services” 13.
\textsuperscript{312} Grogan “Case Roundup: Not transfers” 20.
\textsuperscript{313} Grogan “Case Roundup: Not transfers” 20.
\textsuperscript{314} Bosch “Of business parts and human stock” 1868.
\textsuperscript{315} Grogan “Case Roundup: Not transfers” 20.
\textsuperscript{316} Grogan “Case Roundup: Not transfers” 20.
\textsuperscript{317} Bosch “Of business parts and human stock” 1868.
business within the meaning of section 197(1)(a) the court must move on to ascertain whether that business transferred “as a going concern”.  

Grogan is of the view that Landman J was clearly wrong when he held in Staman that the addition of the word “service” did not make a material difference to the definition of “business” in section 197. However, that conclusion might well stand in similar circumstances; obviously, much will depend on the details of the arrangement between the temporary employment service and the employer.  

But where the intention is simply to get the labour broker to find workers to provide a service (for example, security) there seems no reason why, in the light of Rand Airport, this might not be deemed to constitute the transfer of a service as a going concern.

4.3.3 *SAMWU v Rand Airport Management Company (Pty) Ltd:* the LAC decision

This was the first LAC decision on the consequences of section 197. The unanimous court held that the case turned exclusively on the interpretation, scope and application of the new section 197.

The LAC attached great significance to the addition of the word “service” to the definition of “business”. In its ordinary meaning the word means “the provision of a facility to meet the needs or for the use of a person or a person’s interest or advantage”.

The LAC ruled that a contract to outsource gardening functions is a service within the meaning of section 197. The contractor, therefore, will automatically inherit the people engaged in this function on their existing terms and conditions of employment. This judgment reverses the Labour Court decision (see paragraph 4.3.1 above), where it was found that the outsourcing of the gardening function fell outside of section 197. The Labour Court was bound by the decision of the LAC in the *University of Cape Town* matter.

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318 Bosch “Of business parts and human stock” 1868 1869.
319 Grogan “Outsourcing services” 13.
320 Grogan “Outsourcing services” 13.
322 Grogan “Outsourcing services” 6.
323 Grogan “Outsourcing services” 6.
325 Beaumont “Outsourcing is dead” 50.
Until this judgment there was doubt over the application of section 197 to the outsourcing of non-core functions, such as security.\textsuperscript{326} As part of a cost cutting exercise the employer, Rand Airport, sought to outsource the gardening and security services. It described the event as a section 197 transaction, to which the union agreed, but then changed its approach and said that section 197 did not apply and proceeded to terminate the services of employees involved with the respective functions. The union sought relief of the court that section 197 applied and that the employees be automatically transferred to the contractors, that is, without having to negotiate new contracts of employments and maintaining the same levels of pay.\textsuperscript{327} The Labour Court found for the employer.

In the meantime, the definition of a business, for the purposes of section 197, was amended to include a service. It is also important to bear in mind that the CC subsequently pronounced on the section, thereby rendering some earlier decisions nugatory.\textsuperscript{328} The CC had overturned the \textit{University of Cape Town} LAC decision, which had bound the Labour Court.\textsuperscript{329}

The LAC found that the activities to be provided by the contractor “provide compelling justification for the conclusion that both the gardening and security functions fell within the word ‘service’ as contemplated in section 197”.\textsuperscript{330}

The LAC had to determine whether or not a transfer had taken place. Had the outsourcing been completed? The agreement with the gardening contractor had been signed. The security contractor held back from finalizing the agreement. The LAC found that the gardening contract fell within section 197 and that for security would similarly fall under section 197 if it was signed.\textsuperscript{331}

The LAC missed an opportunity to deal properly with the issue of outsourcing and section 197. It noted that this section had been amended to include a service, took the ordinary grammatical meaning of the word (which is wide in itself) and found that the contractual obligations of the contractor fell with this definition. Therefore section 197 applied.\textsuperscript{332}

\textsuperscript{326} Beaumont “Outsourcing is dead” 50.
\textsuperscript{327} Beaumont “Outsourcing is dead” 52
\textsuperscript{328} Beaumont “Outsourcing is dead” 50.
\textsuperscript{329} Beaumont “Outsourcing is dead” 52.
\textsuperscript{330} SAMWU & others v Rand Airport Management Company (Pty) Ltd & others [2005] 3 BLLR 241 (LAC) 19.
\textsuperscript{331} Beaumont “Outsourcing is dead” 53.
\textsuperscript{332} Beaumont “Outsourcing is dead” 53.
A service is ostensibly based around people; then does a group of people gathered together in a function constitute an entity? This judgment is questionable and the Labour Court’s views are preferred.333

The CC in NEHAWU v University of Cape Town334 held that section 197 automatically applies on the merits. If the facts do not warrant the application of section 197, then the transfer of people to the third party will require their prior agreement; this was given in the Rand Airport matter.335

The implications of this judgment are wide-ranging for outsourcing contracts and are likely to have created more, rather than less, confusion.336

The first and obvious lesson to be derived from the Rand Airport (LAC) judgment is that outsourcing may in some cases constitute the transfer of a business that attracts the provisions of section 197, and possibly section 187(1)(g)337 of the LRA. The judgment also confirms that whether a particular outsourcing arrangement constitutes such a transfer depends on the facts.338

Unfortunately the LAC did not spell out in detail why it reached the conclusion that these particular outsourcing arrangements constituted transfers of services as going concerns, nor did it explain why the Labour Court’s conclusions were wrong. The LAC’s reasoning appears to be that, once it is accepted that a unit of an employer’s organisation performs certain functions for the employer, any arrangement in terms of which those functions will henceforth be performed by another entity will constitute a transfer of part of that employer’s business, and hence trigger the consequences spelled out in section 197.339

If that proposition now represents the law, it is hard to conceive of any outsourcing arrangement that will not be hit by section 197.340

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333 Beaumont “Outsourcing is dead” 53.
334 2003 (3) SA 1 (CC).
335 Beaumont “Outsourcing is dead” 53.
336 Beaumont “Outsourcing is dead” 54.
337 S187 Automatically unfair dismissals (1) A dismissal is automatically unfair if the employer, in dismissing the employee, acts contrary to section 5 or, if the reason for the dismissal is (g) a transfer, or a reason related to a transfer, contemplated in section 197 or 197A.
338 Grogan “Outsourcing services” 11.
339 Grogan “Outsourcing services” 12.
340 Grogan “Outsourcing services” 12.
The LAC did not make entirely clear what factors would be taken into account in determining when an outsourcing amounts to a transfer; it does not, therefore provide a final answer to the question whether all outsourcing arrangements will fall within the ambit of section 197.\textsuperscript{341}

\textsuperscript{341} Basson et al \textit{Essential Labour Law} 177.
CHAPTER 5
OUTSOURCING

5.1 INTRODUCTION

Outsourcing is the process in terms of which an enterprise unbundles itself by contracting with other entities to perform some of the tasks previously performed by its own employees. In its usual forms, outsourcing is a temporary arrangement: the outsourcer concludes a contract with the service provider for a specific period, and reserves the right to renew the contract at the end of the period, or not to renew it. This means that depending on how the contractor performs, the outsourcer may decide to perform the outsourced functions again itself, or award the contract to another.342

Outsourcing in this basic form is no longer referred to as outsourcing or contracting out, it is now referred to as first generation outsourcing.343

In its primary sense of ceasing to undertake an activity itself and contracting with an outsider for the provision of the service or the performance of the work in question, outsourcing will always be around whenever organisations perceive that it is to their advantage to engage in outsourcing.344

The sale of a business, that is, the legal transfer thereof, or a merger is markedly different from outsourcing; the latter involves the putting out to tender of certain services and the contractor performs the outsourced service for a fee and, usually, for a fixed period.345

The sale of a business leads to different consequences; the business or part thereof changes hands permanently.346

In a case of outsourcing, the contractor retains the right to terminate the contract and to perform the services again itself, if it so wishes, when the contract expires.347

342 Grogan & Gauntlett “Second-generation outsourcing” 10.
343 Wallis 2.
344 Wallis 1.
345 Grogan & Gauntlett “Case roundup: Latest judgments and awards” 26.
346 Grogan & Gauntlett “Case roundup: Latest judgments and awards” 26.
347 Grogan & Gauntlett “Case roundup: Latest judgments and awards” 26.
Many outsourcing arrangements are predicated on savings, especially in regard to labour costs.\(^{348}\) But the reduction of costs is not the only driver. Where a particular activity demands more of managerial time and attention that management regards as appropriate, for example, where more attention is being paid to catering or cleaning or security than to profit-making activities or activities for which the organization was established, management use outsourcing as a possible solution.\(^{349}\) Another driver could be that the organisation can obtain a better or more complete service by looking outside the organization which is more available and affordable than using internal resources alone.\(^{350}\)

To “outsourcing” means to contract with another entity to perform a particular service currently rendered by a specific department at a set fee. Pulling in an independent service provider is attractive to employers because it transfers the headaches as well as the employees to an outside entity.\(^{351}\)

What, if any, are the rights of workers when their employer decides to outsource their work to a contractor? The question is likely to become increasingly important as employers in the private and public sector latch on to the idea that it might be more efficient and cost-effective to concentrate on their “core business” and to leave support services to be rendered by outsiders who are usually cheaper and possibly better at such work.\(^{352}\)

### 5.2 CAN OUTSOURCING BE A TRANSFER IN TERMS OF SECTION 197?

Section 197 does not deal directly with the question of whether outsourcing or contracting-out of services can be a “transfer” for the purposes of section 197.\(^{353}\) Do employees whose functions are outsourced transfer automatically to the sub-contractor?\(^{354}\)

Section 197 covers the sale or transfer of going concerns. Many mergers, acquisitions and disposals of major operations which in essence retain their identity or capacity after the event falls

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\(^{348}\) Beaumont “Outsourcing is dead” 50.
\(^{349}\) Wallis 2.
\(^{350}\) Wallis 2.
\(^{351}\) Grogan “Outsourcing services” 3.
\(^{352}\) Grogan & Gauntlett “Outsourcing workers” 15.
\(^{353}\) Bosch “A survey of the 2002 Labour Legislation Amendments” 48 49.
\(^{354}\) Grogan “Outsourcing services” 3.
within this scope. Outsourcing contracts do not automatically constitute section 197 transactions, but could do so depending on the circumstances.\textsuperscript{355}

There is a fine line between outsourcing and the transfer of a business. Outsourcing is deemed to have taken place when a business closes down part of its operation and contracts with another concern to do the same work. This would not generally be regarded as a transfer of business because the sub-contracting business is a wholly separate entity operating for its own account. However, it can also be a disguise for a closer relationship. When, then will such an arrangement amount to a transfer of the business of the contracting company?\textsuperscript{356}

Whether an outsourcing contract can be described in this way will depend on the facts of each case.\textsuperscript{357} As some outsourcing contracts can fall within section 197 it may be useful to introduce fresh terminology by distinguishing between transfers of going concerns and subcontracting.\textsuperscript{358}

Distinguishing features of subcontracting, namely, outside section 197.\textsuperscript{359}

- Function continues
- Fee paid for services rendered but key money not uncommon
- Control/supervision retained
- Client retains monitoring staff
- Opportunity to render services created
- Typically fixed period. No continuity guaranteed. Can lose renewal to a competitor.
- Insourcing a practical/real option
- Multiple transferees

These are indicators rather than conclusive features. Each case should be considered on the specific merits. No single factor will be decisive. An overall assessment must be made after weighing up all the factors.\textsuperscript{360}

Outsourcing contracts will not automatically constitute transfers of going concerns. Size, function, control, duration and potential to reintegrate will be key considerations in assessing whether a

\textsuperscript{355} Beaumont “Section 197 Transactions” 321.
\textsuperscript{356} Grogan & Gauntlett “Unilateral transfers of service contracts” 15.
\textsuperscript{357} Beaumont “Section 197 Transactions” 324.
\textsuperscript{358} Beaumont “Section 197 Transactions” 321.
\textsuperscript{359} Beaumont “Section 197 Transactions” 325.
\textsuperscript{360} Beaumont “Section 197 Transactions” 325.
particular contract falls within the scope of section 197. The features above should be used in the structuring of outsourcing contracts to achieve an intended result.361

If an outsourcing operation is found to be a “transfer” in terms of section 197, the result is that the contractor (or “new employer”) must employ the employees concerned on terms and conditions which are “on the whole not less favourable” than those of their previous employment.362

Outsourcing operations are frequently aimed at achieving a reduction in labour costs through, inter alia, a reduction in “benefits”. This object would be frustrated if the transaction is found to be subject to section 197. To the extent that such “benefits” are found to enjoy constitutional protection, however, a court would be bound to interpret section 197 in accordance with the limitation clause (section 36) of the Constitution. This would involve an inquiry into the extent to which section 197 may permit the limitation of the “benefits” in question. The court would be bound to interpret section 197 “in compliance with the Constitution”363 and, hence, to “promote the spirit, purport and objects of the bill of Rights”.364 The court would have to seek as far as possible to give effect to the employees’ continued enjoyment of the benefits in question. While the outcome of such an inquiry would not be a foregone conclusion, it would increase the likelihood of outsourcing operations and other forms of business transfers being brought within the scope of section 197.365

Outsourcing presents two problems: the first is that the sub-contractor may not want to take on any or some of the workers who have been providing the service concerned, this leaves the employer with the problem of retrenching them; which then gives rise to the second problem, may the employer do so, or is the sub-contractor bound to employ the workers for purposes of the contract?366

If outsourcing does not constitute a transfer of a business as a going concern, workers affected by outsourcing still do not automatically transfer to the sub-contractor if the sub-contractor does not want them. If outsourcing does constitute a transfer of a business as a going concern, the workers do automatically transfer.367

361 Beaumont “Section 197 Transactions” 326.
362 Du Toit “Other basic rights relevant to labour” 4B35.
363 S3(b) of the LRA.
364 S39(1) of the Constitution.
365 Du Toit “Other basic rights relevant to labour” 4B35.
366 Grogan “Outsourcing services” 3.
367 Grogan “Outsourcing services” 4.
Bosch is of the view that the fact that a “business” is defined in section 197 as “the whole or a part of any business, trade or undertaking or service” could be taken as an indication from the legislature that the section should apply to outsourcing.\(^{368}\)

However, Wallis advocates that an inference cannot be drawn from the inclusion of a service in the definition of business, that there was an intention to bring within the operative portion of section 197 a contract for the provision of services. It is never in question in first-generation outsourcing that at least one and usually both parties are a “business, trade or undertaking” and that also holds true for second-generation outsourcing.\(^{369}\)

5.3 “SECOND-GENERATION CONTRACTING OUT”

Second-generation contracting out occurs where there is an initial outsourcing from one employer (A) to a contractor (B) and after some time, the contract with B is cancelled and awarded to another contractor (C). Is C obliged to take over the employees of B who perform the functions in terms of the contract; thus is there a transfer as a going concern between B and C because the contract is awarded to C?\(^{370}\)

According to Bosch, this term refers to a situation where an employer has outsourced a function to a service provider and the contract between those parties come to an end. The employer then concludes an agreement for the provision of the relevant services with a new contractor. The terms “second-generation contracting-out” and “outsourcing” are not terms of art and it is not important to determine whether a particular transaction qualifies as one or the other to bring it within section 197.\(^{371}\)

The concept of “second-generation contracting-out” was mooted as an example by Mlambo J in *NEHAWU v University of Cape Town*\(^{372}\), which concerned the situation that would arise at the end of the first outsourcing contract, if the principal (the old employer) decided to award the contract to another sub-contractor. The scenario would have changed, the functions performed by the contractor could no longer be described as a “service”.\(^{373}\) What had originally been a service

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\(^{368}\) Bosch “A survey on the 2002 Labour Legislation Amendments” 49.

\(^{369}\) Wallis 9.

\(^{370}\) Laubscher “Employment law update: section 197” 2005 *De Rebus* 49.

\(^{371}\) Bosch “*Aluta continua*” 85.

\(^{372}\) [2000] 7 BLLR 803 (LC).

\(^{373}\) Grogan “Outsourcing services” 12.
would now have become the sub-contractor’s business, if the contract was its only contract, or a part of its business, if it had other service contracts. But on the face of it, the new contractor would have taken over the business or part of the business of its unsuccessful competitor as a going concern, especially where, as in the case of many outsourcing contracts, the sub-contractors use the premises and equipment of the principal.374

The question left undecided in Rand Airport (LAC) was: what happens to the contractor’s employees if the contract is awarded to another contractor?375 This question was raised by the Labour Court in the University of Cape Town (LC) matter:

“If outsourcing is a transfer of a business in terms of [the original] section 197, I do not see how the contractor who loses the contract can transfer its employees to the successful contractor as it has no say in who gets the contract. That, say, remains vested in the outsourcing party. Conversely, I do not see how the outsourcing party can force the successful contractor to take over the employees of the outgoing contractor. This scenario illustrates the difficulties regarding outsourcing as a transfer of a business.”376

If, however, the substitution of a new contractor constitutes a transfer of business as a going concern from the old contractor, it would be impossible for any other contractor to bid for the contract, unless it is prepared to take over the old contractor’s staff. As far as Grogan is concerned, “that could sound the death knell of outsourcing contracts as we know them”.377

Sub-contractors in second-generation outsourcing contracts are not the agents of the principal, they merely perform a particular service or particular services for the principal. The transfer of business or service from a principal to a sub-contractor entails the withdrawal from that business or service by the principal, which retains its role only as the ultimate determinant of whether the first and succeeding sub-contractors will retain the contract.378

According to Wallis, the term “first generation” is only relevant if there is a second to follow it and second-generation is nothing of the sort.379 Second-generation outsourcing does not arise from one party ceasing to undertake certain work itself through its own employees and deciding to contract with a third party for the performance of that work on its behalf.

374 Grogan “Outsourcing services” 12.
375 Grogan & Gauntlett “Second-generation outsourcing” 10.
376 NEHAWU v University of Cape Town [2000] 7 BLLR 803 (LC) 32.
377 Grogan “Outsourcing services” 12.
378 Grogan & Gauntlett “Second-generation outsourcing” 12.
379 Wallis 2.
Wallis feels that the expression “second-generation outsourcing or contracting out” is catchy but an inaccurate way of describing a situation where there is no need for the first party ever to have undertaken the work itself. It describes nothing more than a decision by a party to change its supplier, that is, where the principal has contracted with another to perform certain work or provide certain services and for any variety of reasons, the principal decides to change contractor.  

Wallis’ view is that “merely because there may have been some prior outsourcing decision by the principal does not make the change of contractor into an outsourcing of any generation. Precisely the same issues arise even if the principal never at any stage undertook the relevant work through the medium of its own employees. A change in auditors, cleaners, security guards or any other form of supplier of goods and services is legally and economically the same thing, whether or not the work was previously done ‘in house’. There is no justification for describing this as an ‘outsourcing’ or ‘contracting-out’ of any generation...Telling the farmer or the cold storage contractor or the dietician that all fruit is the same fruit albeit of different generations is a recipe for disaster, not to say some rather quaintly composed fruit salads.”

Looking at the example of the changing of auditors, the effect will be that when auditors are changed at an organization, the auditors from firm A will automatically transfer to firm B and will continue to do the audit, thereby defeating the very purpose of changing auditors.

The position is complicated further by including ‘contracting-in’ or ‘third generation outsourcing’ under the explanation as second-generation. ‘Contracting in’ or ‘third generation outsourcing’ refers to the decision by a principal to terminate a contract for the provision of work or services and to use its own employees or employ people itself to undertake the work.

5.4 **COSAWU V ZIKHETHELE TRADE (PTY) LTD & ANOTHER**

5.4.1 Facts and finding

This judgment brought the question of the application of section 197 to “second-generation contracting-out” starkly to the fore.
The question regarding the position when the outsourcer cancels the contract with the original contractor and concludes a new contract with another, and what happens to the employees of the unsuccessful contractor, arose in a welter of confusing facts in this matter.386

COSAWU’s members were employed by Fresh Produce Terminals (FPT) to load ships. FPT decided to outsource its terminal and stevedoring services to black economic empowerment (BEE) company, Khulisa. Amidst allegations of impropriety, FPT terminated the contract with Khulisa. FPT then invited the factions within Khulisa to apply for the contract, one faction was registered as Zikhethele Trade. Each of the new companies then tendered for the FPT contract.387

The COSAWU members, who all worked in Cape Town, backed a rival tenderer. The contract was awarded to Zikhethele to perform the terminal and stevedoring services. The rival tenderer launched an urgent application in the High Court to interdict the implementation of the contract, pending an application for review of the tendering process, but that application fizzled out when the rival was unable to provide security for costs.388

Khulisa then went into provisional liquidation. COSAWU then asked Zikhethele to indicate whether its Khulisa members were to be transferred to it (Zikhethele) or retrenched. Without answering the union’s inquiry, Zikhethele informed its (Khulisa) employees that they would be “seconded” to Zikhethele for one year if they applied for positions, but that they would remain employees of Khulisa. After the “secondment” period lapsed, Zikhethele allowed the employees to continue working on the same basis for a further month, then told the employees that the “secondment” would end, and advised them that they would be informed which of them the respondent would employ. The union believed that the contracts had transferred automatically to the respondent by virtue of section 197. COSAWU sought an order in the Labour Court declaring that they had been automatically transferred to Zikhethele.389

Prior to this judgment it had been argued that section 197 could not apply to second-generation contracting-out because the section speaks of a transfer of a business by the old employer. The argument is that in the second-generation scenario, the transfer is by the client to whom the service is being rendered and not the old employer, that is, the outgoing contractor.390

386 Grogan & Gauntlett “Case Roundup: Double transfer” 19.
387 Grogan & Gauntlett “Case Roundup: Double transfer” 20.
388 Grogan & Gauntlett “Case Roundup: Double transfer” 20.
389 Grogan & Gauntlett “Case Roundup: Double transfer” 20.
390 Bosch “Aluta continua” 86.
The court had to decide whether the facts fell within the terms of section 197, to do so the court would have to find that the economic entity of which the business was comprised had transferred as a going concern from FPT to Khulisa, then from Khulisa to Zikhethele.\(^{391}\)

There was no doubt about the first stage – FPT had outsourced its business to Khulisa, and the employees had gone with it. But the further question whether they transferred again at the next stage, that is, when the outsourcing arrangement with Khulisa was cancelled and the new outsourcing contract was concluded with Zikhethele, took the court into uncharted waters. If not, those employees would lose the protection of the first transfer.\(^{392}\)

The Labour Court noted that it was in new territory. It was certainly arguable that the cancellation of an initial outsourcing contract and its transfer to a second bidder does not attract the provisions of section 197. On the other hand, a contractual link between the transferor and the transferee is not a necessary precondition for the application of section 197.\(^{393}\)

The court described the situation as “second-generation contracting out” which occurs when a company that has “outsourced services to a contractor and when the initial contract comes to an end puts the opportunity to provide the service out to tender, whereupon the original contractor is unsuccessful in its bid to secure the contract for an additional term”.\(^{394}\)

The Labour Court resolved the issue with a purposive interpretation of section 197. Employees affected by a “second-generation” outsourcing contract are as deserving of protection as those affected by the first.\(^{395}\) The court adopted this approach to avoid the anomaly, which would otherwise be created by exempting second-generation outsourcing arrangements from its provisions.\(^{396}\)

The anomaly is the fact that, once it is recognised that workers affected by a first-generation outsourcing arrangement may transfer automatically from their former employer to the contractor, it makes sense not to extend that possibility, and the protection conferred by section 197 on the affected employees, to second and subsequent outsourcing arrangements with different contractors. Otherwise the door would be opened to possible abuse.\(^{397}\)

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\(^{391}\) Grogan & Gauntlett “Second-generation outsourcing” 11.
\(^{392}\) Grogan & Gauntlett “Second-generation outsourcing” 11.
\(^{393}\) Grogan & Gauntlett “Case Roundup: Double transfer” 20.
\(^{394}\) COSAWU v Zikhethele Trade (Pty) Ltd & another [2005] 9 BLLR 924 (LC) 27.
\(^{395}\) Grogan & Gauntlett “Case Roundup: Double transfer” 20.
\(^{396}\) Grogan & Gauntlett “Second-generation outsourcing” 12.
\(^{397}\) Grogan & Gauntlett “Second-generation outsourcing” 12.
Section 197(1)(b) must accordingly be interpreted to include within its scope transfers of business from one employer to another, not only to transfers by the old employer. The anomaly would be eliminated if the word by was substituted by the word from. Furthermore, a second-generation transfer can be viewed as a process in terms of which the business is handed back to the old employer by the first contractor, and in which the employer then transfers the business to the new contractor.

The preposition by suggests that the old employer must effect the transfer, which clearly does not occur when the first contractor drops out of the picture because the principal decides (usually without the first contractor’s consent) that the services will henceforth be performed by another contractor.

Such a pragmatic interpretation, the court said, would allow a finding “that a business in actual fact can be transferred by the old employer in such circumstances, but that the transfer occurs in two phases: in the first, the business is handed back to the outsourcer and in the second it is awarded to the new employer.”

5.4.2 The two phase transfer

Murphy AJ explained that such a transfer takes place in two phases, namely the business is first handed back to the initial owner (A) and then transferred anew to the successful tenderer (C).

If the cancellation of the first outsourcing arrangements results in a temporary reversion of the business to the outsourcer before its transfer to the new contractor, the transfer is still effected by the old employer.

The “two phase” view of second-generation outsourcing arrangements may yield an interpretation of section 197 more consistent with the intention of the lawmaker.

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399 Grogan & Gauntlett “Case Roundup: Double transfer” 20;
400 Grogan & Gauntlett “Second-generation outsourcing” 12.
402 Laubscher “Employment law update” 49.
403 Grogan & Gauntlett “Second-generation outsourcing” 13.
Such an interpretation of section 197 would accord with the Bill of Rights and with international labour law and practice. The true issue is whether what is transferred is a business in operation which remains the same but is in different hands after the transfer.\footnote{Grogan & Gauntlett “Case Roundup: Double transfer” 20.}

But such an interpretation does not help service providers who make their living out of outsourcing arrangements. Entities tendering for such contracts obviously have to seek to undercut the current contractor, and it may be difficult to do so if they are required by law to take over the current contractor’s staff on the same or at least similar conditions of service.\footnote{Grogan & Gauntlett “Second-generation outsourcing” 13.}

Labour costs would not be the only problem. The new contractor would be bound by collective agreements concluded by its predecessor and by any arbitration awards or judgments against it.\footnote{S197(5)(b).} For a twelve month period, the new contractor would be jointly and severally liable with its predecessor to any employee who becomes entitled to receive a payment as a result of the employee’s dismissal for a reason relating to the employer’s operational requirements or the new contractor’s liquidation or sequestration.\footnote{S197(8).} Both contractors would be jointly and severally liable for meeting any claim concerning any term or condition of employment that arose prior to the transfer.\footnote{S197(9).}

Whether these joint obligations and liabilities can be foisted on the principal in terms of the “two phase” approach, remains to be seen.\footnote{Grogan & Gauntlett “Second-generation outsourcing” 13.}

Whether a transfer of business has occurred is a question of fact that must be determined in the circumstances of each transaction. Turning to the facts, the Labour Court held that there were a number of indications that the business of Khulisa had been transferred to Zikhethel as a going concern. Khulisa and Zikhethel had the same top management structure and majority shareholder; they also shared facilities and the major asset of both companies was the same stevedoring and terminal services contract. This meant that after FPT’s acceptance of the tender by Zikhethel, the business retained its identity to a sufficient degree to constitute a transfer of a business as a going concern. The former FPT employees had accordingly been automatically transferred to Zikhethel.\footnote{Grogan & Gauntlett “Case Roundup: Double transfer” 20.}
The court concluded that
“on a narrow comparison between the actual activities and the actual employment situation in the two companies before and after FPT’s award of the tender to Zikhethele, the business as a going concern had retained its identity to a sufficient degree as to constitute a transfer of business.”

5.4.3 Was Zikhethele correct?

Grogan is of the view that the court could probably have concluded that Khulisa’s business had transferred as a going concern to Zikhethele without resorting to the “two phase” approach or amending the plain language of section 197(1)(b), because the court had concluded that “the business as a going concern had retained its identity to a sufficient degree to constitute a transfer of business”.

In reality, all that interposed itself between the outsourcing of FPT’s business to Khulisa was a nominal new contract between Khulisa and Zikhethele. But for the notional separate corporate identities of the two companies, Khulisa was effectively contracting with itself when it “outsourced” its business to Zikhethele.

There seems to be no reason why in Zikhethele the court could not have disregarded the corporate veil to uncover the true nature of the transactions, and determine whether they fell within the ambit of section 197.

Although the transaction between Khulisa and Zikhethele may formally have constituted a second-generation outsourcing contract, it clearly had unique features, such as the fact that the two companies had the same “puppet master”. That factor would clearly be absent in a genuine second-generation outsourcing arrangement in which the second contractor had outbid the first in a genuine tender.

According to Bosch, it was unnecessary to find that the transfer occurred in two phases because of the interpretation of section 197 adopted by the court. If one accepts that section 197 applies to transfer from one employer to another, how the transfer occurred is insignificant. All that is

413 Grogan & Gauntlett “Second-generation outsourcing” 14.
414 Grogan & Gauntlett “Second-generation outsourcing” 14.
415 Grogan & Gauntlett “Second-generation outsourcing” 14.
416 Grogan & Gauntlett “Second-generation outsourcing” 14.
important is that the entity that is transferred is a “business” and that it is transferred from the old employer to the new employer as a going concern.417

However, Wallis disagrees, “transfer” contemplates only two positive actors in the process, namely the old employer and the new employer, and no-one else. There must be an identifiable business, which includes a part of a business, and that must be the subject of the transfer by the old employer to the new employer. The current section 197 says that the old employer is a positive actor in the process. This is not what occurs when an institution has concluded a contract for the provision of cleaning services and at the expiry of the contract puts it out for tender and the existing contractor loses the tender. Here the role and function of the old employer is to strive to keep the contract, not to transfer all or any part of its business to someone else and when it does not succeed in being awarded the tender, it does not extend a hand of congratulations to the winner and promise it every support.418

Murphy AJ decided that “a less literal and more purposive approach is justified in the context of section 197” and accordingly interpreted the word by as from which changes the whole meaning of the definition.419

Wallis’ view is that the fact that “it might [as the acting judge said] be better” as a matter of policy if that had been the wording of the definition, is simply no excuse for changing the words that the legislature after careful consideration and much debate put there.420

“No dictionary that I have consulted equates ‘by’ with ‘from’ in any of their varied meanings. The clear meaning of ‘by’ in the definition is: ‘indicating agency, means, cause, attendant circumstance, conditions, manner, effects’.421 =422

The word ‘by’ indicates that the transferor has a positive role to play in bringing about the transfer and its replacement by the word ‘from’ eliminates that role and reduces the transferor to a passive position in which it may not only not do anything to bring about the transfer but may possibly have fought against it.423

417 Bosch “Aluta continua” 88.
418 Wallis 10.
420 Wallis 11.
422 Wallis 12 13.
423 Wallis 13.
The amendments to the LRA were subject to considerable debate, yet, in Wallis’ view, the legislature did not see fit to alter this aspect of the original section 197, namely a transfer ‘by’ the old employer ‘to’ the new employer.\(^{424}\)

Bosch on the other hand is of the view that an assumption could be made that the legislature did not apply its mind to the matter because there is no indication that the debates prior to the introduction of the amendments dealt with the application of section 197 to second-generation contracting out.\(^{425}\)

Wallis argues that the provisions of section 197(7)\(^{426}\) which are mandatory but incapable of being fulfilled unless the old employer and the new employer are in a contractual relationship reinforces the legislatue's intention, for example, imagine a disgruntled contractor, who has just lost a valuable contract to a competitor, willingly entering into a contract with its successful rival of the nature required by section 197(7).\(^{427}\)

If the legislature was of the view that the old employer and the new employer would be in a direct relationship, then compliance with section 197(7) would be straightforward.\(^{428}\)

Bosch indicates that it is trite that the fact that legislation is going to cause difficulty and reluctant compliance has never prevented the legislature from passing such legislation. Legislation is often introduced to compel parties to do what they would otherwise choose not to do. The fact that requiring an agreement from the outgoing contractor might be awkward or meet with resistance cannot be taken as a sign that the legislature did not intend it.\(^{429}\)

However, assuming the intention of the legislature based on the above could amount to treading in rough waters. Wallis argues that it is highly dangerous for a judge to presume the he or she can

\(^{424}\) Wallis 13.
\(^{425}\) Bosch “\textit{Aluta continua}” 89.
\(^{426}\) S197 Transfer of contract of employment (7) The old employer must - (a) agree with the new employer to a valuation as to the date of the 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) disclosure 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).
\(^{427}\) Wallis 13.
\(^{428}\) Wallis 13.
\(^{429}\) Bosch “\textit{Aluta continua}” 89.
discern the intention of the legislature not simply from words unspoken but from legislation in other countries which is worded differently from the LRA so as to include matters that the words themselves clearly exclude.

“In anyone’s language ‘by’ does not and cannot mean ‘from’.”430

An approach based on the language of section 197 would have arrived at the same conclusion without any need to explore the topic of second-generation contracting-out or to alter the wording of the section.431

What is required is a transfer by one party to another and that had clearly taken place, the business of the old employer (Khulisa) had been transferred by Khulisa to the new employer (Zikhethele).

There is a difficulty with suggesting that to give the section its plain meaning, gives rise to an anomaly. Wallis indicates that it does nothing of the sort unless one assumes that first-generation outsourcing is within the section and equates it with second-generation outsourcing, and this should not be done because the first assumption is not necessarily correct and secondly the two are not the same thing.432

“If there is in truth some anomaly in section 197 of the LRA then the proper way to deal with that anomaly is not by way of a judge amending the section in the guise of interpretation but by way of an amendment or a constitutional challenge on the basis that the LRA does not sufficiently protect employees against unfair labour practices in section 197.”433

5.4.4 Practical implications

If section 197 were to apply to second-generation contracting out, various practical implications could arise because the incoming contractor would have to take on the employees of the outgoing contractor on their existing terms and conditions.434

For example, a person tendering for a contract will find it difficult to determine the appropriate amount to quote for providing its services because information regarding the existing terms and conditions and other necessary information, may not be generally available and it is unlikely that

430 Wallis 14.
431 Wallis 15.
432 Wallis 15.
433 Wallis 16.
434 Bosch “Aluta continua” 90.
the outgoing contractor, who may be competing for the contract, will be happy to provide this information to its competitors.

Bosch is of the view that these problems are not insurmountable and points out that the outgoing contractor is not the only source of the information. The information may be known to the client, the trade union and, of course, the employees. Bosch suggests that the client might make it a term of the contract that there is an obligation on the existing contractor to provide prescribed information to those wishing to tender for the contract; or, if the legislature deemed it necessary, to amend section 197 to introduce a requirement that the existing contractor make the necessary information available to those tendering for the contract.

Would this not lead to an undercutting of wages in the industries involved as the clients turned to outsourcing as a means to reduce costs and could thus merely grant the contract to the most cost-effective tenderer?

Bosch says that it is conceivable that prospective contractors will tender on the basis of reduced labour costs and the terms and conditions of employees doing the same jobs at the same place year after year will be systematically whittled down with each successive service contract. But Bosch suggests that the South African government should be concerned at the prospect of contractors being able to compete by cutting labour costs as opposed to cutting other costs or improving efficiency.

The CC in University of Cape Town reiterated that section 197 was intended to give blanket protection to employees whose employers transfer a whole or part of their businesses as going concerns. Section 197 protects workers in that the transfer of a business may not be used as a basis to retrench workers or reduce their terms and conditions. Would the employees subjected to second-generation contracting-out scenarios receive this protection if their terms and conditions were whittled down by successive service contracts?

435 Bosch “Aluta continua” 90.
436 Bosch “Aluta continua” 91.
437 Bosch “Aluta continua” 92.
438 Grogan “Outsourcing services” 4.
439 Bosch “Aluta continua” 96.
5.4.5 **In the wake of Zikhethela**

The question to be asked is whether all second-generation outsourcing arrangements will attract the provisions of section 197, or will only some of them?

It remains to be seen whether the Labour Court will apply the “two stage” approach. If so, it could mean the end of competitive tendering in the outsourcing industry.\(^{440}\)

The *Zikhethela* case may have far-reaching consequences for employers conducting business in the service industry. If it can be said that the business initially outsourced from A to B will retain its identity after the transfer to C, section 197 is likely to apply, which means that C will be obliged to take over the employees on the same terms and conditions of employment.\(^{441}\)

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\(^{440}\) Grogan & Gauntlett “Second-generation outsourcing” 14.

\(^{441}\) Laubscher “Employment law update” 49.
CHAPTER 6
CONCLUSION

Much controversy was created by the finding of the LAC in *NEHAWU v University of Cape Town*\textsuperscript{442} that the transfer of contracts of employment in terms of section 197 was dependent on agreement to this effect between the old and new employers. Any precedent set by this finding, however, was short lived. By the time the judgment was handed down, the amended section 197 had almost completed its passage through Parliament, while the judgment itself was decisively overruled by the Constitutional Court some ten months later.\textsuperscript{443} It was perhaps ironic that a definitive judgment on the meaning of the original section 197 was handed down by *NEHAWU v University of Cape Town (LAC)* on the eve of its replacement.\textsuperscript{444}

The current section 197 has an economic role in allowing for the preservation of an economic entity when there is a change in ownership. The consent of the employees is not required and their employment is automatically transferred to the purchaser.\textsuperscript{445} The automatic application and the consequences when this happens is subject to agreement. For example, it may be impractical to transfer employees as the buyer is to relocate the business acquired, in which event the parties can agree on a termination of employment.\textsuperscript{446}

Structure, wording and reality will ultimately all determine whether a particular transaction constitutes the transfer of an undertaking or a mere disposal of assets. There may be times when an employer specifically wishes to ensure that a transaction constitutes a transfer of an ongoing concern and in other situations the converse may apply. In both situations, the various pointers can be usefully followed or avoided, as the case may be. In cases of doubt, seek the specific agreement of the various stakeholders, particularly the employees. Remember above all that substance will prevail over form.\textsuperscript{447}

Bearing in mind that the purpose of section 197 is to balance and protect the interests of both the employee and the employer, it is a perfectly reasonable theory that the legislature deliberately decided to limit the scope of section 197 to those transactions where two parties decide to bring

\textsuperscript{442} [2002] 4 BLLR 311 (LAC).
\textsuperscript{443} Du Toit et al *Labour Relations Law* 447.
\textsuperscript{444} Grogan “A twist on transfers” 14.
\textsuperscript{445} Beaumont “Business transfers” 135.
\textsuperscript{446} Beaumont “Business transfers” 135.
\textsuperscript{447} Beaumont “Outsourcing” 562.
about a change in ownership of a business by whatever means, but not to extend the section to more remote situations as has occurred elsewhere.\textsuperscript{448}

However, Bosch advocates that

“in interpreting and applying section 197, the courts should not lose sight of the purpose of the section in securing the employment and rights of employees in times of business transfer and this entails that the scope of application of the section should not be narrowly tailored...The courts are going to have to decide in which situations the protections conferred by section 197 should properly be extended to employees. Employees are vulnerable during the processes of business restructuring and the proper protection of employee rights may require the courts to construe section 197 more widely than narrowly... It is imperative that the courts develop a clear and coherent jurisprudence around when section 197 applies and what its effects will be... the section has far reaching consequences and it is thus crucial for employers and employees to have clear guidance as to when those consequences need to be considered”.\textsuperscript{449}

Wallis sums up the debate accurately:

“... if we are going to have a statutory provision that deals with the transfer of businesses it should be confined to that subject and that subject alone.”\textsuperscript{450}

If the provisions of section 197 are properly utilised it should not have the effect of hamstringing employers or inhibiting business transfers, as it contains a number of mechanisms that enable parties to ensure that it operates in a manner that is in the best interest of employers and employees.\textsuperscript{451}

A mere change in service provision is not necessarily sufficient to trigger the application of section 197 in light of the test for the transfer as a going concern formulated by the CC in University of Cape Town. That requires an examination of all the components of a business in order to determine whether the business has transferred for the purposes of section 197. No single factor is determinative. In addition, that test indicates that a “business” cannot be reduced to one of its components, for example the opportunity to work for a particular client.\textsuperscript{452}

The question then still remains: does section 197 apply to second-generation outsourcing?

\textsuperscript{448} Wallis 13.
\textsuperscript{449} Bosch “Of business parts and human stock” 1882.
\textsuperscript{450} Wallis 17.
\textsuperscript{451} Bosch “Of business parts and human stock” 1882.
\textsuperscript{452} Bosch “Aluta continua” 94.
The interpretation of Wallis regarding whether section 197 applies to second-generation outsourcing, clearly concludes the situation:

"More rigorous thinking about the fundamental differences between the two concepts would suggest that far from abuse being easy to imagine it is extremely difficult to imagine how to dress up a first-generation contracting-out to which the section would apply as a second-generation contracting-out to which it would not."453

The need for further amendments to the current section 197 will be revealed as employers and workers continue their forensic battles.454

453 Wallis 15.
454 Grogan & Gauntlett “Welcome changes” 3.
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