THE LABOUR LAW CONSEQUENCES
OF A TRANSFER OF A
BUSINESS

by

MOGAMAD SHAHIED ABADER

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Shaheed Abader
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SUMMARY

The burden that South African labour law has to bear in relation to the economy is very heavy by international standards. In most industrially developed countries, the economy is strong enough either to provide jobs for most work-seekers or, failing that, an adequate social security system for households without breadwinners in place. In most developing countries with high unemployment rates, the labour law system makes only perfunctory effort to reach out to those facing economic marginalisation. South Africa, essentially a developing country, is not like that.

The legal system is strong, works off a firm human rights base, and sets out to grapple with the issues. That is how it should be, but it comes at a price – an often-graphic exposure of the limits of the law in a stressed society. Businesses operate for profit and survival according to the unsentimental ways of the market, and employees back in a bid to save jobs, lifestyles and livelihoods. The stakeholders use power when they have it, and make claims on the law when they don’t. The legislation and the case law reflect, add to and, to a degree, shape the complexities of these contests, and no more so than in the area of business restructuring.¹

The new South Africa has quickly become the destination for foreign investment. The weakness of the rand against the dollar, pound, euro and with the “cost to sell and produce” being so low against these currencies, players on the corporate stage constantly change their make-up and composition. The larger engulfs the smaller, one company buys shares in another, or buys it out entirely, or all or part of its assets, and others are liquidated. In all these situations, employees in South Africa may find themselves with new bosses on the morning after. Under common law employees in this situation were deemed to have been discharged by the former employer, whether or not they have 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 a

This research is conducted at an interesting time, when the amendments to the Labour Relations Act 66 of 1995 in respect of the transfer of a business, and in particular section 197, dealing with such matters comes into effect. It is also interesting in the sense that most judgements of the Commission for Conciliation, Mediation and Arbitration (CCMA) and judgements of the Labour Court were moving more or less to a common approach or interpretation of section 197 of the Labour Relations Act 66 of 1995 (hereinafter “the LRA”).

Section 197 of the LRA sought to regulate the transfer of a business as a going concern and altered the common law regarding the transfer of a business in two situations – firstly when there is no insolvency, factual or legal, concerned, and secondly in the instance where the transferor is insolvent. The first extreme was when an employer is declared insolvent and the contracts of employment terminated automatically. The second extreme was from the first whereby the employer has to terminate the services of his employees and be liable to pay severance pay in terms of section 189\(^3\) of the LRA, which has also been amended along with section 197 of the LRA. It is as if this section was introduced to remedy these extremes. These extremes will be dealt with in detail in this paper.

The transfer of goodwill and assets from the seller to the buyer occurs when a business is sold as a going concern. At common law the employees of a business cannot be transferred in the same manner. The Labour Relations Act 66 of 1995 altered this position. By enacting this section the legislature wanted to protect the interest of the employees in such transactions. Whether the legislature has succeeded or not is a matter that will be dealt with in this paper. It is all dependent on the interpretation of this section by the commissioners and judges. By including section 197 in the LRA, the legislature’s intention was to resolve the common law problem where employment contract terminated upon the sale of a business, and this


\(^3\) S189 deals with dismissal based on operational requirements.
section was intended to be an effective tool for protecting the employment of employees.

In order to understand the labour law consequences of the transfer of a business, it is important to understand the provisions of sections 197 and 197A of the Labour Relations Amendment Act 2002. This will be dealt with and each section will be discussed in detail using relevant case law and literature.

In considering investing in a South African based company by way of purchasing a share of the company and giving it your own flavour, one has to carefully consider the effects of this transaction. Companies wishing to restructure, outsource, merge or transfer some of its operations will need to understand what the implications of the labour legislation will have on their commercial rationale.

Section 197 regulates the employment consequences when a transfer of a business takes place. This is defined to mean the transfer of a business by one employer (the old employer) to another employer (the new employer) as a going concern. Business is defined to include the whole or part of the business, trade undertaking or service. Like the current provision, the new provision refers to the transfer of a business. It is therefore a wider concept than the sale of a business.\(^4\)

No attempt is made to define what constitutes a going concern and the controversial issue of whether an outsourcing exercise can constitute a going concern transfer is also not explicitly dealt with. The fact that a business is defined to include a service may be an indication that it was intended to typify outsourcing as a going concern transfer, but this is not necessarily the case.\(^5\)

The amendments to the Act\(^6\) came into effect on 1 August 2002. Sections 197 and 197(A) of the Act consequently seek to regulate the transfer of a business. These regulations will be dealt with individually and in a format that would make each of the sections in sections 197 and 197(A), easy to understand and interpret. It will also

\(^4\) S197(2)(a) and (b) of the Labour Relations Act 66 of 1995.
\(^5\) S197(1)(b).
become clear as to what the implications of each of the subsections will have on that commercial rationale.

The issues highlighted above will be dealt with detail in this paper giving an overview of the Common Law, the Labour Relations Act 66 of 1995 and the new Labour Relations Amendment Act 2002.
CHAPTER 1

TRANSFER OF A BUSINESS – THE COMMON LAW

1.1 THE COMMON LAW

One of the problems, which have vexed labour lawyers for many years, concerns the fate of employees when a business is sold or becomes insolvent and is then transferred. This problem shows a close practical connection to dismissal for operational reasons simply because many business are sold because they are unhealthy and accordingly require restructuring, or because the sale implies new management with a new vision for the company which may also lead to restructuring.\textsuperscript{7} By the same token, insolvency in effect means that the employer could not meet its operational dictates and the business is often taken over by another, solvent, employer.

When a business is sold, the position of employees in terms of the common law is simple: no employee may be compelled to continue his or her contract of employment with the new employer. This of course is cold comfort to most employees who would like to stay on, especially in a country with high unemployment, because the common law also provides that the new employer is not obliged to employ them. A transfer of a business would therefore mean the necessity of the termination of existing contracts of employment. As far as insolvency is concerned, the general rule is that insolvency of the employer terminates existing contracts of employment. Despite this, it is a fact of economic life that an insolvent business does not necessarily cease to operate, it may still be bought by another concern and given a lifeline, or some arrangement with creditors may ensure its survival.\textsuperscript{8}

This, in turn, means that it is relatively easy to come to the point where fairness dictates the need to legislatively protect employees in the case of a transfer or

\textsuperscript{7} Basson et al Essential Labour Law Vol 1 (1998) 2\textsuperscript{nd} ed 224.
\textsuperscript{8} Supra ft 5.
insolvency of a business. This need was recognised by the Industrial Court in terms of its unfair labour practice jurisdiction, but was not given effect to in that dispensation.  

1.2 STATUTORY MODIFICATION OF THE COMMON LAW

In spite of increasing statutory intrusion, the common law contract of employment remains the basis of the employment relationship in the sense that the legal relationship between employer and employee in created by it.

The process of statutory intrusion was initiated by a general realization that the common law had lagged behind conditions in modern commerce and industry and, more recently, the entrenchment of a range of new fundamental constitutional rights.

Some deficiencies of the common law contract of employment to which legislators in various countries have given attention can be stated as follows:

(a) The common law does not cater for the inherent inequality in bargaining power between the employer as owner of the means of production and the employees, who are entirely dependent on supply and demand for their welfare and job security.

(b) The common law pays no regard for the enduring nature of the employment contract, giving the employee no inherent right to press for better conditions of employment as time goes by.

(c) The common law does not promote participative management, in which workers have a meaningful say in at least those management decisions which directly affect their working conditions and legitimate interests.

(d) The common law does not provide effective protection to job security of employees.

9 See Kebeni v Cementile Products (Ciskei) (Pty) Ltd (1987) 8 ILJ 442 (IC).
1.3 TRANSFER OF CONTRACTS

The common law knows no notion of transfer of a contract. A contract commences a life bond between two or more parties and cannot change its character.\textsuperscript{11} The transfer of goodwill and assets from the seller to the buyer affects when a business is sold as a going concern. At common law the employees of a business cannot be transferred in the same manner. They are not inanimate objects and their contracts with the seller must be terminated.\textsuperscript{12}

Under the common law, the sale of a business in general meant termination of the contracts of employment of existing employees and left it up to the purchaser to decide whether or not to offer them re-employment.\textsuperscript{13} The Industrial Court recognised the need to protect employees under these circumstances, by requiring fair retrenchment procedures.

1.4 PROTECTION UNDER COMMON LAW

In\textit{ Kebeni v Cementile Products (Ciskei) Ltd}\textsuperscript{14} Bulbulia M held that, in addition to timeous consultation with the employees’ bargaining agents and adequate notification to the employees, safeguards should be incorporated into the agreement between the employer and the purchaser of the business, to ensure that the interests of the work-force are adequately protected – for example, a clause deeming all existing contracts of employment to be transferred to the purchaser. The member of the Industrial Court also referred to the (British) Transfer of Undertakings: Protection of Employment Regulations of 1981, which provide for the automatic transfer of contracts when a business is sold as a going concern.\textsuperscript{15}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{11} Brassey Commentary on the Labour Relations Act Vol 3 (1999) A8:91.
\item \textsuperscript{12} Grogan “Going Concerns. Unilateral Transfers of Service Contracts” (1999) 15(1) EL 14.
\item \textsuperscript{13} Brassey supra A8:85.
\item \textsuperscript{14} Supra.
\end{itemize}
\end{footnotesize}
Understandably, however, the Industrial Court hesitated to order a remedy with major social-economic policy implications, and employees accordingly acquired no right to continued employment on the transfer of a business where they worked.¹⁶

**1.4.1 THE COMMON LAW**

Under common law it is not possible to automatically transfer contracts of employment. The employment contracts can only transfer by agreement of the employee. What in fact happens is that the contract with the “old” employer terminates and a contract with the “new” employer comes into existence.

The rule against non-consensual transferability of employment contracts did not however create major problems for employers under common law. The reluctant employee could simply be dismissed on notice. However as the size of the payouts to which employees became entitled to by law or by collective agreement increased, so employees became a potential major factor to consider when businesses or undertakings were transferred.¹⁷ Under the 1956 Labour Relations Act, the problem remained uncertain whether retrenched employees were entitled to severance pay as of right where fairness so demanded. The first problem with the old Labour Relations Act 28 of 1956 was that is was uncertain whether retrenched employees were entitled to severance pay and especially the pre-retrenchment procedures.¹⁸ The second problem was the requirement to consult and to pay severance pay to employees that would be affected by retrenchments.

An attempt was made to address these problems by the introduction of section 197 of the Labour Relations Act 66 of 1995, which addressed the question of transfer of a business as a whole or in part as a going concern or in the absence or presence of insolvency or liquidation and the plight of employees in such a business.

It will become clear below that this section was not without interpretational difficulties.

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¹⁶ Supra.
¹⁷ Labour Relations Act 28 of 1956.
CHAPTER 2

SECTION 197 OF THE LABOUR RELATIONS ACT 66 OF 1995

2.1 PURPOSE

It is often said that when a business is bought, sold or goes into liquidation, employees are the last to know. The Labour Relations Act seeks to address this situation. Section 197 is new to the LRA and contains provisions, which are open to considerable interpretation.\(^{19}\) The rationale behind the introduction of section 197 of the Labour Relations Act, 66 of 1995, is to protect employment in the event of a transfer of a business as a going concern. This appeared \textit{inter alia} from the fact that the section is part of the chapter regulating employment security, and therefore gives effect to the constitutionally entrenched right to fair labour practices contained in section 23(1) of the Constitution of 1996.\(^{20}\) The explanatory memorandum which accompanied the Act in its draft stage (the Draft Labour Relations Bill) explained the position in the following terms:

\begin{quote}
"The draft bill explicitly deals with the employers’ rights and obligations in the event of a transfer of an undertaking. This resolves the common law requirement that existing contracts of employment must be terminated and new ones entered into, which leads to the retrenching of employees, the paying of severance benefits etc and escalates costs in a way that inhibits these commercial transactions."
\end{quote}

Provision was made in the draft bill for the automatic transfer of contracts of employment to the transferee provided that the employees consent to the transfer. One of the innovative elements of the Labour Relations Act 66 of 1995 was the provision that contracts of employment will transfer to the new employer if there has been a transfer of a business as a going concern. Although this was new to South Africa, this was not the case in other parts of the world. In Europe for example, the Transfers Directive of 1977 has had a similar effect in the European Communities (Union) members states. Britain adopted the Transfer of Undertakings (Protection of

\(^{19}\) Andersen and Van Wyk \textit{Labour Law in Action – A Practical Hands on Guide} (1997) 46.

\(^{20}\) Constitution of the Republic of South Africa.
Employment) Regulations already in 1981, while article 613 of the German Civil Code regulates the same issues.\textsuperscript{21}

Section 197 of the LRA applies when the whole or part of a business, trade or undertaking is transferred from one employer to another as a going concern. It has two main consequences. In terms of section 197(1) contracts of employment between the old and the new employer may be transferred without the employee’s consent if the old employer and the new employer agree to such a transfer. Section 197(1) is permissive, if the new employer is not willing to take over the contracts of employees of the old employer it cannot be compelled to do so. Except in the case of insolvency, the old employer will be compelled to retrench its employees subject to the provisions of section 189 of the LRA, 1995, and pay them severance pay.\textsuperscript{22}

2.2 TRANSFER OF THE CONTRACT OF EMPLOYMENT

Section 197(1) of the LRA provided that a contract of employment may not be transferred from one employer to another without the employee’s consent, unless:

\textit{“The whole or part of the business, trade or undertaking is transferred by the old employer as a going concern”}

This section therefore stated the common law principle relating to the transfer on non-going concerns, but introduced the exception that a contract of employment can be transferred without the consent of the employee \textit{if the business is transferred as a going concern}\textsuperscript{23} The reason for this exception is evident from section 197(2) which provides:

\textit{“If a business, trade or undertaking is transferred in the circumstances referred to in subsection (a), unless otherwise agreed, all the rights and obligations between the old and the new employer and each employee continue in force as if they were rights and obligations between the new employer and each employee, and anything done before the or in relations to the old employer will be considered to have been done in relation to the new employer”}

\textsuperscript{22} Grogan \textit{Workplace Law} (2001) 6\textsuperscript{th} ed 208.
It was argued that section 197(2) does not stipulate that the contract of employment is automatically transferred to the new employer without the new employer’s consent. The primary argument in favour of this view was that the automatic transfer of the contract of employment would render the exception in section 197(1)(a) unnecessary as the employee’s consent would obviously not be required prior to the transfer of his or her employment contract. In view of the apparent ambiguity, this section was presumed to be consistent with the common law rule that the employment contract is not automatically transferred pursuant to the sale of a business. A contrary view was, however, that section 197(2) affected the automatic transfer of contracts of employment in the event of a sale of a business as a going concern. This view entailed that the transferor and transferee could not agree that the contracts of employment would not transfer.

Some commentators challenged the notion that the Act foresees an automatic transfer of the contract of employment. They drew attention to the fact that the relevant section of the Act was not drafted in clear terms. At the time it was suggested that the legislature follow the provisions of the 1977 Transfers Directive of the European Communities in this regard, and that automatic transfer should be accepted. The Labour Court accepted in Manning v Metro Nissan a division of Venture Motor Holdings that an automatic transfer of the contract of employment follows once there has been compliance with the requirements set out in section 197. A transfer of employment contract without the employees consent could only occur where there has been a transfer of the business undertaking as a going concern. If the business is not transferred as a going concern the transfer of the employment contracts will be in contravention of section 197 and thus unlawful. This was dealt with in Kgethe & Others v LMK Manufacturing (Pty) Ltd. Employees who object to the transfer may terminate their contracts unilaterally or by consent. This was also the approach adopted by the European Court of Justice in Merckz v Ford Motor Company Belgium SA.

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24 Grealy et al supra 51.
28 (1996) IRLR 467 (ECJ).
2.2.1 THE LEGAL EFFECT OF TERMINATION

An interesting question is what the legal effect of the termination will be? If it has occurred by consent, one would expect that the terms of the agreement will dictate the consequences. For example, it might have been agreed that the employee will be offered alternative employment, or that the severance monies will be paid. Where the employee has unilaterally terminated his services this would be viewed as a resignation by the employee, with the consequence that the employee would not be entitled to severance benefits, since there has been no dismissal.

2.2.2 CONSTRUCTIVE DISMISSAL

The question is: “Can the employee claim constructive dismissal”? One would hardly think that in our law the mere transfer could be regarded as a form of constructive dismissal. However there may be circumstances attached to the transfer, which could possibly leave the employees concerned with such a claim. For example where the employer who is known to be on the verge of insolvency, could this not constitute compliance with the LRA requirement that the old employer has made continued employment intolerable?29 A constructive dismissal claim remains a potential threat, as the LRA does not require the stringent common law test that the employer must have breached the contract, but merely that continued employment has been made intolerable. This was the case in Unilong Freight Distributors (Pty) Ltd v Muller.30

2.2.3 WHEN DOES A TRANSFER TAKE EFFECT?

It is clear that the effective date need not be the date of the actual signing of the deed of transfer, as the mutual decision to transfer could predate the official (written) conclusion of the sale.31

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29 S186(e) of the Labour Relations Act 66 of 1995.
31 See Manning v Metro Nissan a division of Venture Motor Holdings Ltd and Another (1998) 19 ILJ 1181 (LC).
2.3 TRANSFER OF RIGHTS AND OBLIGATIONS

The transfer of an employment contract to another employer amounts to a change in the employee’s terms and conditions of employment as the identity of the employer is a fundamental aspect of one’s employment. Prior to making the decision to transfer the assets of the business and the contracts of employment, the old employer should therefore engage in consultation with the affected employees. Section 84 of the LRA,\textsuperscript{32} provides that a workplace forum must be consulted by the employer about proposals relating to the transfer of a business. This provision has the effect that the employer must engage in consultation with both the workplace forum and the individual affected employees prior to making a decision to transfer the business of the company.

Section 197(2)(a)\textsuperscript{33} stipulated that 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 the 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. The converse applies in the event of an insolvency-related transfer, or where the scheme of the arrangement or compromise is employed in the course of a rescue operation: the rights and obligations do not transfer.\textsuperscript{34} In other words, while employees are not meant to lose their jobs because of an insolvent or rescued entity is being transferred; there is an apparent attempt not to burden the liquidator unnecessarily and excessively as far as the contractual implications of such a transfer are concerned. However, the legislature makes it clear that a contrary agreement can be entered into.

There are a few issues that merit reflection. The first is that both Labour Appeal Court and the Labour Court appear to accept as axiomatic that once there is a transfer of a going concern on non-solvency related instances, there is an automatic

\begin{itemize}
\item \textsuperscript{32} Labour Relations Act 66 of 1995.
\item \textsuperscript{33} Supra.
\item \textsuperscript{34} S197(2)(b) of the Labour Relations Act 66 of 1995.
\end{itemize}
transfer of concomitant rights and obligations, unless a contrary agreement has been entered into. In *LMK Manufacturing*, the LAC remarked:

“If in fact a transfer of a going concern had been effected, the appellants would be entitled to the benefits accorded to them to reject any other benefits which either the respondents sought to accord them in lieu thereof.”

In *NUMSA & Another v Success Panelbeaters & Service Centre CC t/a Score Panelbeaters & Service Centre*\(^{35}\) the court referred to the formulation of section 197(2)(a) as “Enabling and empowering words. They confer legislative right and power on the individuals referred to (each employee). Conversely they create a duty on the person against whom it is conferred (the new employer) to exercise it. The enabling words are construed as compulsory whenever the object of the power is to effectuate a legal right. In the present matter, it is precisely these rights of the applicant that require the exercise of power.

The second issue concerns the range of persons or institutions that have to be involved in the event that a contrary agreement is sought. Section 197(3) states that such an agreement must be concluded with the appropriate person or body referred to in section 189(1)\(^ {36}\) in other words, the same body or person that has to be consulted for the purposes of a dismissal based on operational requirements. It would therefore appear contrary to the belief held by some, that the reversal of the rule (in a situation envisaged by section 197(2)(a) that rights and obligations will transfer would require the express consent of those affected by the reversal (or their representatives). This was made clear in *Carol Keil v Foodgrow (Pty) Ltd.*\(^ {37}\)

What is the effect on the employment of an employee where the old employer transfers the business where she works to someone else? The Labour Appeal Court posed the question in these terms when it turned, for the first time, fully to consider the effects of section 197 of the Labour Relations Act 66 of 1995, on the contractual rights of the employees when the business by which they are employed are transferred to new owners by sale, merger, takeover or whatever devices have been

\(^{35}\) (1999) 20 *ILJ* 1851 (LC).

\(^{36}\) S189 of the Labour Relations Act 66 of 1995: Dismissal based on operational requirements.

contrived in the business world to switch ownership from one person, natural or juristic to another. The matter came before the court in *Foodgro, a division of Leisurenet Limited v Keil*\(^{38}\) at the behest of the company that had acquired another called MacRib. Foodgro appealed after the Labour Court held that it had unfairly retrenched Ms Keil by disregarding her period of service with MacRib when it selected her for dismissal on the basis of LIFO and that Foodgro was obliged to pay her severance pay for the period in which she worked for MacRib. Foodgro contended that it was entitled to disregard the period in which she has worked for MacRib.

The Labour Court (Mlambo J) held that Ms Keil had been unfairly retrenched because Foodgro had incorrectly selected her when applying Keil v Foodgro a division of Leisurenet Limited (1999) BLLR 345 (LC) the “last in, first out” (LIFO) method of selection. Mlambo J’s finding was that Ms Keil’s period of employment should have been calculated from the date she commenced working for MacRib. That finding was based on section 197 of the LRA, the effect of which Judge Mlambo analysed as follows:

“Section 197(2) specifically provides that all rights and obligations between the old employers and each employee, at the time of the transfer continue to remain in force as if they were the rights and obligations between the new employer and each employee, unless, of course, the parties agree otherwise. One of the rights of employees at the time of transfer is the right of accruing by virtue of length of service. The new employer's obligations in this regard it to recognize this length of service especially should it decide to retrench the employee concerned.”

The transferred employee, in fact acquires several substantive rights by virtue of the accumulation of his length of service. One, identified by the Court, is the right to have the period of service with the old employer taken into account if and when the new employer contemplates retrenchment. Another, is also identified by the court, is to have the years of service with the old employer taken into account when quantifying severance pay. Others are rights that are acquired under statute, contract or collective agreement by length of service, such as accrued leave or long service leave or a right to be upgraded or promoted.

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\(^{38}\) (1999) 9 BLLR 875 (LAC).
The third issue relates to some of the practical implications of the rule that rights and obligations will transfer. It is clear that such a transfer does not affect seniority rights. The provision in section 197(4), which states that a transfer referred to in section 197(1) does not interrupt the employee’s continuity of employment, makes this clear. It implies that in the event that the transferred employees are at a later stage retrenched by the new employer, the period of service with the old employer, and any period of service which the old employer may have taken into account, would be relevant for the purposes of using LIFO as a selection criteria and for the purposes of calculating severance benefits. This was also the case in Deppe v Bauhaus Confectionery.39

It would appear that the transfer of rights and obligations does include the transfer of statutory rights and obligations as well, such as statutory rights to severance benefits. This was also confirmed in the SACWU v Engen Petroleum Ltd.40 This could however have an impact on which forum to approach. In the event of pure statutory benefits issues, the CCMA would have to be approached, while in the event of a contractual arrangement in this regard, the Labour Court or possibly even the High Court may be the court vested with jurisdiction.41

2.4 TRANSFER OF PENSION FUNDS

Section 197 only deals with the transfer of pension funds partially. The Pension Funds Adjudicator remarked that the rights and obligations secured by section 197 are limited to those rights and obligations existing between the employer and employee, which may include some but not all pension rights (such as, the employer’s contributions where there is a contractual entitlement thereto). The matter was dealt with in Younghusband & Others v Decca Contractors (SA) Pension Fund and Its Trustees.42 The failure of section 197 to guarantee full continuity in pension rights is explicable by the fact that the legislature presumably considered the

40 (1998) 19 ILJ 1568 (LC) at 1572A-B.
41 See the Engen case; s77(3) of the Basic Conditions of Employment Act 75 of 1993 read with s41.
42 (1999) 20 ILJ 1640 (PFA).
matter adequately catered for in section 14 of the Pension Fund Act.\footnote{Pension Funds Act 24 of 1956.} The latter sections contains certain requirements in the event of the amalgamation and transfer of pension funds and is applicable where contracts of employment are transferred in such a way requiring the employees to transfer from one pension to another.

### 2.5 TRANSFER OF A BUSINESS AS A GOING CONCERN

Section 197 begins by saying that a contract of employment may not be transferred from one employer to another without the employee’s consent, unless two sets of circumstances apply. One is where the “whole or part of the business, trade or undertaking is transferred by the old employer as a going concern”. The other is 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. In other words the common-law rule against non-consensual transfer of contracts of employment is entrenched, except in the case of transfers so described or insolvencies. Where a business is transferred in these circumstances. 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 the rights and obligations between the new employer and each employee.

In Schutte & Others v Powerplus Performance (Pty) Ltd and Another,\footnote{(1999) 2 BLLR 169 (LC).} the applicants, former employees of the second respondent, a firm called Super Rent Trading (Pty) Ltd, sought a declaratory order that they were employed by Powerplus Performance and an order interdicting Powerplus from altering the terms and conditions of employment until the matter had been conciliated by the relevant bargaining council. The applicants were employed in three workshops in Gauteng, for an enterprise called Super Rent, a division of Super Group. Supergroup and Powerplus entered into an agreement with a few other companies in terms of which Super Group would purchase fifty percent of the shares in Powerplus. Part of the agreement was that Super Group undertook to sell its workshops to Powerplus. The net result was that employees in Super Group were informed that the workshops
were closing. They were given forms to apply for positions in Powerplus. They were also informed that they would earn less from their new employer than they had earned from Super Group. When the workers hesitated they were told that, if they did not apply to Powerplus, they would be retrenched. Some employees took retrenchment packages, while other including the applicants relied on section 197 applied for positions with Powerplus with all their rights reserved.

The applicants contended that they were entitled to be paid the same at Powerplus as they had received from Supergroup. Everything depended on whether the agreements entered into between Super Group and Powerplus amounted to a transfer of the whole or part of the formers’ business to the latter. 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 operations and contracts with another concern to do the same work.

Landman J ruled in urgent proceedings that the contracts of two former employees of Super Group had been “automatically transferred” to Powerplus and interdicted Powerplus from changing their contracts of employment before that matter was conciliated. On the return date the employees were joined by eleven of the former colleagues, sought a declaratory order that all the rights and obligations that had existed between Super Group and them continue under Powerplus. Seady AJ concluded as follows:

“'The provisions of section 197 were part of the Act’s mechanisms to provide security of employment in times of change, it fell to the court to give meaning to the terms of the section.”

Since that had not been done before in South Africa, Seady AJ turned for guidance to international jurisprudence, in particular to interpretations of the Acquired Rights Directive of the Council of the European Communities and to decisions of the courts of England, where the provisions similar to those of section 197 had been in force for some time. The judge found a morass of principles and qualifications and concluded:

“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.”

Seady AJ was further able to distill an approach from the jurisprudence of the English courts in which the judge noted, 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. She then concluded:

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

This the court said was consistent with the approach adopted by the Labour Appeal Court in *Kgethe v LMK Manufacturing*,\(^45\) in which it was held that, when determining whether a transfer of a business as a going concern had taken place.

2.6 TERMINATION OF EMPLOYMENT

Termination of employment for a fair reason and in accordance with a fair procedure will not be affected by section 197 merely because it takes place simultaneously with or pursuant to the sale of transfer of a business.\(^46\) For example new owners may change production procedures in such a manner that employees who have been transferred may not adapt to them. Where this arises under such circumstances the courts may be expected to scrutinize the transaction closely in order to ensure section 197 is not circumvented. In *Snell v SSM Manufacturing*\(^47\) the arbitrator held that “the new owners could reasonably have been expected to develop appropriate systems and procedures in consultation with the manufacturing staff, and allow for a period of a few months to adapt to a clearly defined set of new requirements”.

\(^{45}\) (1998) 19 *ILJ* 524 (LAC).

\(^{46}\) Du Toit *et al* supra 401.

\(^{47}\) (1997) 2 *BLLR* 240 (CCMA).
It was also shown in a recent judgement of the Labour Court in the case of Western Cape Workers Association v Halgang Properties\(^{48}\) that an employer cannot dismiss on the basis of operational requirements in anticipation of a section 197 transfer.

It is clear that that section 197 created some interpretation problems for the Labour Courts and the CCMA. Section 197 was not particularly well drafted and created some practical difficulties. In the next chapter more focus is placed on the difficulties that the section created.

\(^{48}\) (2001) 2 BLLR 125 (LC).
CHAPTER 3

THE DIFFICULTIES WITH SECTION 197 OF THE LRA 66 OF 1995

Section 197 of the Labour Relations Act 66 of 1995, has been described as a “legal monstrosity”. The author who applied that particular epithet to the section suggested that:

“The drafters seem uncertain of the extent to which the transfer of the contract should be non-consensual and know too little about contract and insolvency law to be completely sure of the implications of their handiwork. The result is a section that yields no completely coherent meaning when construed by the conventional canons of statutory interpretation. Each construction, tentatively adopted, meets an insuperable obstacle in the language and must be jettisoned until ultimately there is nothing left but frustration and failure.”

3.1 TRANSFER OF THE CONTRACT OF EMPLOYMENT

The common law knows no notion of a transfer of a contract. A contract commences life as a bond between two or more parties and cannot change its character. It has generally been thought that section 197 of the Labour Relations Act, in its current form, is intended to achieve two objectives. The first is to protect employees whose employer decide to sell or otherwise transfer their business to others; the second is to lessen the burden that the law would otherwise place on employers. The wording in section 197 left much to be desired and although it could be argued that it was intended that the transfer of contracts of employment to the new employer should not, on a proper interpretation of the provision, be compulsory, the Labour Appeal Court made an obiter statement that: “Section 197(1)(a) and (b) provide for the automatic transfer of an employee’s contract of employment upon transfer of the business, trade or undertaking form in the circumstances set out in section 197. It seems therefore, that the issue of the automatic transfer is no longer controversial as the Labour Appeal Court has dealt with the matter even although in an obiter statement, employers could assume that, on a transfer of a business, the employee’s

51 Milo, Molatudi “The Legal Implications of Section 197 of the LRA” People Dynamics (2000) 51.
contracts must automatically transfer to the new employer. It is also submitted that the *Foodgro*\textsuperscript{52} appeal was dismissed with costs, as the Labour Appeal Court agreed with Mlambo J’s ruling and held that Keil’s severance pay should be calculated as though Foodgro had employed her since February 1993 as opposed to January 1997.

The new employer can, to be specific, protect herself by insisting upon a reduction in the purchase price to compensate for liabilities imposed on her by the statute and by inserting warranties in the agreement of sale, of the sort typically found there, that give her recourse against the old employer if she has been misled or things go wrong in an unexpected way.\textsuperscript{53} Integrating the new work-force into an existing one, where this must be done, can of course produce anomalies and unjust disparities, but if contracts of employment are transferred, their terms are not cast in stone, for the usual options of altering terms and conditions of employment are available to the new employer.

This was the case in the *Schutte & Others v Powerplus*\textsuperscript{54} decision, where the court made reference to implementing “the usual options”, which include unilateral changes, lock-outs and retrenchments. This can be difficult, expensive and time-consuming as was the case in *Schoeman & Another v Samsung Electronics (Pty) Ltd.*\textsuperscript{55} The employee on the other hand, would have every reason to be concerned if the Act makes his transfer from the old employer to the new employer automatic and so gives him no say in the matter. Under a contract of employment, the employer must pay the employee his remuneration, give him his fringe benefits and, depending on the circumstances, provide him with work so that he can earn his commission, improve his skills and experience job satisfaction. Few employees take up a new job without giving some thought to whether the employer can make faithful performance of these obligations and many will take lesser payment to secure a better employer.

\textsuperscript{52} *Foodgro, a division of Leisurenet Limited v Keil* (1999) 9 BLLR 875 (LAC).
\textsuperscript{54} (1999) 2 BLLR 169 (LC).
\textsuperscript{55} (1997) 18 ILJ 1098 (LC).
3.2 GOING CONCERNS

Section 197 of the Labour Relations Act 66 of 1995 was the product of political compromise reached within Parliament. Its scope and potential effect was far from clear. This problem was illustrated in the Labour Appeal Court decision of NEHAWU v University of Cape Town and Others, dealing with a fundamental aspect of the section. The section makes it clear that if there is a transfer of a business, or part thereof, as a going concern, the contract of employment of the employees working in the business or part thereof are transferred from the transferor (the old employer) to the transferee (the new employer). This takes place without their consent. If they did not want to work for their new employer they could resign. What was not clear from the formulation is whether the old and the new employer were also bound. Could they agree between themselves that the employees will not be transferred?

This issue was first considered by the Labour Court in Schutte & Others v Powerplus Performance (Pty) Ltd & Another where the court came to the conclusion that with the going concern, transfer the old employer and the new employer cannot by agreement between themselves prevent the transfer of the employees to the new employer. This was accepted in a majority decision of the Labour Appeal Court in Foodgro (a division of Leisurenet) Ltd v Keil. In contrast: in the University of Cape Town decision a majority of the court came to the conclusion that the employers could indeed, by agreement, prevent the transfer of employees.

Another area of uncertainty concerns the question of what constitutes a transfer of a business as a going concern. This has been particularly problematic in the situation where outsourcing takes place. Does the “contracting out” of an employer’s catering or security function constitute a transfer of a part of a business as a going concern? Although this is essentially a factual question, the relatively few decisions of the Labour Court on the issue were not unanimous.

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56 (CA 12/00).
In *Schutte v Powerplus* the court’s reasoning to determine that the business had been transferred as a going concern cannot be faulted. The court followed, correctly the approach adopted in the Court of Justice of the European Communities (EJC) and the English Courts by examining substance over form, and weighting factors indicative of a transfer of a business against those that are not, and made an overall factual assessment without treating one factor as conclusive in itself.\(^{60}\) Despite the seemingly clear language of section 197 certain problems of interpretation have presented themselves. Comparative research by Blackie and Horwitz has shown that uncertainty attaches especially to the concept of “going concern”, the identity of the “old” employer, what is included in the term “transfer”, which rights and obligations are transferred, the extent of the employees’ rights to refuse transfer and the scope for retrenchment of employees prior to transfer.\(^{61}\)

The court also referred to the test formulated in *Spykers v Gebroeders Benedik Abattoir*,\(^{62}\) which was set out as follows:

> “The decisive criterion for establishing whether there is a transfer for the purposes for the directive is whether the business in question retains its identity. Consequently a transfer of an undertaking, business or part of a business does not occur merely because its assets are disposed of. Instead it is necessary to consider, in a case as the present, whether the business was disposed of as a going concern, as would be indicated, inter-alia by the fact that its operation was actually continued or resumed by the new employer with the same of similar activities.”

The court further referred to the decision in *Kenmir Ltd v Frizzel*\(^{63}\) where the following was stated:

> “In deciding whether a transaction amounted to the transfer of a business, regard must be had to its substance rather than its form and consideration must be given to the whole of the circumstance, weighing the factors that point in one direction against those that point in another. The absence of the assignment of premises, stock-in-trade or outstanding contracts will likewise not be conclusive if the particular circumstances of the transferee nevertheless enables him to carry on substantially the same business as before.”\(^{64}\)

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\(^{60}\) Van der Walt “Dismissal for Operational Reasons Prior to the Transfer of a Business as a Going Concern” (1999) *Obiter* 434.


\(^{62}\) *Spykers v Gebroeders Benedik Abattoir* CV 24/85 (1986) 2 CMLR 296.

\(^{63}\) *Kenmir Ltd v Frizzel* (1986) 1 All ER 414 HL.


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The court’s reasoning, with regard to determining that the business had been transferred as a going concern, cannot be faulted. The court referred to the Explanatory Memorandum that accompanied the draft Labour Relations Bill with a view to determine the purpose of the provisions.65

According to the memorandum:

“The draft bill explicitly deals with the employer’s rights and obligations in the event of a transfer of an undertaking. This resolves the common-law requirement that existing contracts must be terminated and new ones entered into, which leads to the retrenching of employees, the paying of severance benefits etc and escalates costs in a way that inhibits these commercial transactions. Provision is made in the Draft Bill for the automatic transfer of the contracts of employment to the transferee provided that employees consent to the transfer. All rights and obligations arising from the contract of employment are transferred. In the case of Insolvency however, the transferee does not take over the accrued entitlements of the employees and the transferor will be responsible for settling claims arising from the employment contracts up until the date of the transfer. The transferee takes over the contracts of employment, but is responsible for wages and claims arising from the date of transfer. The purpose of this proviso is to avoid what might otherwise be an adverse effect on the liquidator’s ability to dispose of the undertaking.”

Based on this, the court comes to the startling conclusion that the primary purpose of section 197 is to protect the rights of employees during certain processes of businesses’ restructuring. This conclusion cannot be gleaned from the Explanatory Memorandum. The wording in section 197 also does not support the conclusion of the court regarding its interpretation. The section commences by stating the common law position that contracts of employment of employees of the transferor may not be transferred. To this an exception is added, namely, that, if the business, trade or undertaking is transferred as a going concern such contracts of employment may be transferred with the employees’ consent.

Section 197(2)66 provides that, if a transfer is affected as stated above, all the rights and obligations between the old employer and each employee continue in force with regard to the transferee. If the transfer occurs because of a scheme of arrangement or a compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency, such rights and obligations are not transferred, but only the

65 Van der Walt supra 434.
contracts of employment. Section 197(4) provides that such a transfer does not interrupt the employees’ continuity of employment.

There is nothing in the section that forbids the transferor and the transferee to agree that the contracts of employment would be transferred. This means that in such an instance the common law position remains in force. The transferor may then terminate the services of employees for operational requirements. The court’s interpretation of the constitutional right to fair labour practices is too liberal in the wording of section 197 does not allow for such interpretation. Other constitutional rights may also demand that such an interpretation not be given to section 197.

The interpretation accorded by the court “may well prohibit businesses in the first instance from the acquisition of, or investment in other businesses and as such, section 197 contributes to the inhibition of economic growth”. It is therefore submitted that the interpretation of section 197 is such that the freedom of the transferor and transferee concerning the transfer of the employees of the transferor is not affected. They may accordingly agree that all, or some of the employees’ contracts of employment will not be transferred. Such employees must be dismissed for operational requirements in accordance with the requirements of fairness implied in the Act.

3.3 TRANSFERS PRIOR TO THE COMMENCEMENT OF THE ACT

The commissioner’s award in Watson and another v Burman Katz Attorneys was based on the fact that each succeeding partnership implicitly and voluntarily “took over” the new contracts of employment. This meant that for the purposes of calculating the severance pay of the applicants from one partnership to another without a break in continuity of employment. Where an employee is retrenched by her employer that took over the business of her former employer prior to 11 November 1996, (that date on which the LRA became effective) the employee’s

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68 Van der Walt supra 436.
entitlement to severance pay goes back to the date of the take-over and not the full period employed by the previous employer. This was because prior to the commencement of the LRA, the takeover of businesses did not result in the automatic transfer of the employment contracts. The commissioner’s second premise was that section 41(2) of the BCEA, makes provision for the compulsory payment of severance benefits to retrenched employees, and applies with retrospective effect.

3.4 INSOLVENCY

Section 1(b)(ii) also indicates that when a businesses, trade or undertaking is transferred as a going concern, because a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency. The phrase “being wound-up” or “sequestrated” make it clear that the section applies to both corporate and individual employers. Companies are “wound-up” and individuals are “sequestrated”. Section 38 of the Insolvency Act provides that upon sequestration of the employer, contracts of employment immediately terminate and the employee is left only with a claim from the insolvent estate for the loss suffered. The section is made applicable to the Companies Act by section 399 of the Companies Act.

If the section operates in accordance with its terms, no contracts exist upon which the present section can fasten and thus nothing can be transferred. One solution is to treat the insolvency section as subordinate to, and so superseded by, the present one to the extent of the clash. Section 210(1), which gives the LRA precedence over other legislation, provides support for this conclusion. It is, however, unworkable, as no one will ever be sure whether a clash exists when the returnable order of sequestration or winding-up is made, since the contingency, on which paragraph (b) is made to depend, still creates uncertainty and is prospective.

74 Insolvency Act 24 of 1936.
When a business goes insolvent, employees cannot claim that they have been “dismissed” within that meaning of the term in the common law or the Labour Relations Act, not at least while the Labour Court’s ruling to this effect in *SAAPAWU v HL Hall & Sons (Group Services) Ltd and Another*, states the law in this regard. In this case Landman J held that the court lacked jurisdiction because what was to happen to the employees could not be described as a dismissal. Since the employers had in this instance decided to liquidate, they would be hard put to contend that they were not proposing to terminate the contracts of their employees, which is one of the forms of dismissal defined in section 186 of the LRA. However, the question was whether the provisions of the LRA were overridden by section 38 of the Insolvency Act, which provides that contracts of employment terminate upon liquidation. Their remedy, such as it was, was to sue for damages, which remedy lay with the High Court, not the Labour Court. If this judgement is correct, its implications are depressing for employees.

The judgement means, in effect, that companies wishing to shut down can escape their obligations to consult with their employees or their unions and to pay severance pay by applying for provisional liquidation orders. This possibility may have been intended by the legislature, but it is doubtful whether the Act’s failure to deal with the effect of section 38 of the Insolvency Act on employees’ rights was anything more than an oversight. However, the Labour Court must surely have the power to enforce compliance with the LRA which is the means by which employees’ constitutional rights to fair labour practices is enforced. To that extent there appears to be some conflict between section 38 of the Insolvency Act and the Labour Relations Act 66 of 1995.

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77 (1999) 2 BLLR 164 (LC).
79 *Supra* no 58 at par 4.
3.5 TRANSFER OF ASSETS OR SHARES

Ndima and Others v Waverley Blankets and Sithukuza and Others v Waverley Blankets\(^{80}\) presented the courts with a different question: whether the sale of shares could amount to a transfer of a business as a going concern as contemplated by section 197(1)(a),\(^{81}\) or as in the case before it, section 197(1)(b)(ii).\(^{82}\) The answer to this question turns to the meaning of “transfer”. Business entities take many and complex forms and their constituent parts can only be deemed to have taken place on the basis of many and subtle considerations. The matter is not that simple. Think of a farming operation – if one sells that farm (the asset) surely one sells the business as well? Is a sale of shares not a way to effectively transfer ownership and control?

3.5.1 SALE OF ASSETS

As far as a sale of shares is concerned, it was held in Kgethe & Others v LMK Manufacturing & Another\(^{83}\) that an agreement to sell a portion of the assets did not constitute a “transfer as a going concern”. This judgement, however, was overturned on appeal, but on the basis that the Labour Court, on the available evidence, was not entitled to make a finding on the true nature of the agreement. This means that the first Kgethe judgement remains tenuous authority for the proposition that the sale of assets does not constitute transfer as a going concern.\(^{84}\)

3.5.2 SALE OF SHARES

In Waverley Blankets, however, the “scheme of arrangement” did not result in the extinction of one company and its rebirth as another. All that happened was that one company had to come to the rescue of Waverley Blankets by buying the majority of its shares. The only aspect that the applicants could rely on, therefore, was the shift in control that the purchase entailed. The applicants’ counsel contended that this

\(^{80}\) (1999) 20 ILJ 1563 (LC).
\(^{81}\) Labour Relations Act 66 of 1995.
\(^{82}\) Supra no 61.
\(^{83}\) (1997) 10 BLLR 1303 (LC).
was enough to amount to a “transfer of a business as a going concern”. Waverley’s counsel argued that a distinction had to be drawn, not only between the transfer of a business (which section 197 contemplates) and the sale of the assets of a business (which it arguably does not), but also between both transfer and sale of the assets, on the one hand, and the sale of shares, on the other. These distinctions compelled Zondo J to turn, as Seady J had done, to English law for guidance. After reviewing case law, Zondo J rejected the applicants’ request to ignore the terms “old employer” and “new employer”. These terms, he noted, refer to both subsections, which deal independently with transfers and insolvencies. In respect of insolvency, however, the applicants had to contend with subsection 2(b) of section 197, which provides that, if a business is insolvent or being wound up or sequestrated, or because of a scheme of arrangement, or compromise aimed at avoiding winding up or insolvency. Zondo J noted that the result pointed to a “crying need for an amendment to section 197 of the Labour Relations Act 66 of 1995 or section 38 of the Insolvency Act, or both”. In the same breath he dismissed the application and granted leave to appeal. A sale of shares seems to be excluded from the ambit of section 197.

3.6 TERMS AND CONDITIONS OF EMPLOYMENT

As far as the terms and conditions of employment, the Act requires that anything done before the transfer by the old employer in respect of each employee will be considered to have been done by the new employer. 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. Quite apart from the areas of uncertainty, section 197 also created some practical problems. For example, in many cases it was difficult, if not impossible, for the new employer to provide the same pension or medical benefits. The section made it clear that if there is a transfer of a business, or part thereof, as a going concern, the contracts of employment of the employees working in the business of part thereof are transferred from the old employer to the new employer. This means that the employment contracts could be transferred without the consent of the employees. If they did not want to work for the new

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85 Grogan “Liquidating Employees” (1999) 15(7) EL.
employer they could resign. What was not clear from the formulation is whether the old and the new employers were also bound. This raised the question: Could they agree between themselves that the employees would not be transferred? The precise purpose and import of the provisions of section 197 compared with the consequences set out in section 197(2) are not always clear. What appears to be stipulated here is that the terms and conditions of employment that applied before the transfer, will continue in force and are enforceable, by and against the new employer. However, given the wide ambit of the rather loose wording used here, it might be possible to interpret these consequences as meaning, for instance, that warnings issued before the transfer will continue to be considered conduct of the old employer and will not be deemed conduct of the new employer. This will result that such warnings would not continue in force. Surely, however, this could not have been the intention of the legislature.

There is little doubt that section 197 of the Labour Relations Act 66 of 1995 created serious inroads on the ability of businesses to determine whom it wants to employ and on what basis. Furthermore, the court in Schutte, against the background of the constitutional right to fair labour practices, gave a very liberal interpretation of that section. This means that evasion of its effect may well be very difficult in practice. In turn this means that criticism of the section falls back on the argument that it may well prohibit businesses in the first instance from the acquisition of, or investment in, other businesses and as such that section 197 contributes to the inhibition of economic growth.

3.7 INFORMATION- SHARING AND CONSULTATION

It appears as if incomplete attention has been paid by the drafters of section 197 in regard to enforcing information sharing and consultation with employee representatives. The section does not deal specifically with the issue of disclosure of information and has not made the provisions of the Act in this regard applicable in the event of a transfer of a business as a going concern – except where a workplace

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forum has to be consulted\textsuperscript{89} or a trade union has required acquired bargaining rights.\textsuperscript{90} Recently the Labour Appeal Court made it clear that the Labour Court has the power to order the disclosure of information for purposes of determining the true nature of the transfer. That is whether there was a transfer as a going concern.\textsuperscript{91} Contrary to the position in the European Union,\textsuperscript{92} section 197 does not require consultation on the transfer (barring, of course, the limited obligation to enter into an agreement \textit{ie} when the new employer wishes to agree on terms and conditions of employment different from those existing with the old employer. The Labour Court has until now not been prepared to find whether there is a duty to consult, or negotiate with the employees prior to the transfer.\textsuperscript{93}

There are, however some exceptions to this. The Act makes it clear that the transfer of undertakings is a matter over which an employer must enter into consultation with a workplace forum, in case a contrary agreement has not been arrived at.\textsuperscript{94} The same applies to total or partial plant closures and to mergers.\textsuperscript{95} The duty to consult on the case of mergers and the transfer of ownership extends only in so far as they (the mergers and transfers) have an impact on the employees.

The Act is also silent on whether or not an employee may be dismissed for the purposes of or in the course of a transfer. In the European Union, the transfer of the undertaking does not in itself constitute grounds for dismissal by either the old or the new employer, although this provision does not stand in the way of the dismissals that may take place for economic, technical or organisational reasons entailing changes in the workforce.\textsuperscript{96}

There has been little development on this issue in the jurisprudence on section 197. One could argue that since the services of the employees are to be retained, the provisions relating to dismissal for reasons based on operational requirements are

\textsuperscript{89} S89 of the Labour Relations Act 66 of 1995.
\textsuperscript{90} S16 of the Labour Relations Act 66 of 1995.
\textsuperscript{91} See \textit{Kgethe v LMK Manufacturing (Pty) Ltd} (1998) 19 ILJ 524 (LAC).
\textsuperscript{92} See article 16 of the Transfers Directive.
\textsuperscript{93} See \textit{SACWU v Island View Holdings Ltd} (1998) 19 ILJ 882 (LC).
\textsuperscript{94} S84(1)(d) of the Labour Relations Act 66 of 1995.
\textsuperscript{95} S84(1)(c) of the Labour Relations Act 66 of 1995.
\textsuperscript{96} S4(1) of the Transfers Directive.
applicable.97 Of course, where there are genuine operational requirements present, there is in principle no reason why the old or the employer may not rely thereon in order to reduce the size of the workforce. It is submitted, in keeping with the position of the European Union, that the mere transfer does not constitute such grounds and that a narrow construction should accordingly be given to the notion of “operational requirements” in this regard. This approach also seems to be necessitated by the general purpose behind the adoption of section 197, which is to preserve employment. In any event, it is clear that occurring within the context of a transfer will be scrutinised closely in order to ensure that the protection extended to employees by section 197 is not circumvented.98

Furthermore, where the old employer has dismissed an employee unfairly, it is incumbent on the new employer to give effect to the order of reinstatement, where the new employer has acquired the business after the dismissal but before the unfair dismissal finding.99 Assuming that a dismissal is directly connected to the transfer is not countenanced, the question remains what the legal effect of such a dismissal is. Is it an invalid/automatically unfair dismissal, or a dismissal where the fairness still has to be investigated? Clarity in this is lacking, as our courts and the CCMA have not dealt with this specific issue. In Europe the purpose appears to be that an employee who has been dismissed by reason of the transfer, and not for economic, technical or organisational reasons, is deemed still to be in employment.100

3.8 CONCLUDING REMARKS

It is evident that the interpretation of section of the Labour Relations Act 66 of 1995 is fraught with great difficulties. There are many unanswered questions, while courts, in the absence of clear legislative provisions, generally appear to be extremely cautious to develop principles in a little known area. Some of the most difficult matters, which have been discussed here, relate to many problems inherent in the interplay between section 197 of the Labour Relations Act and section 38 of the Insolvency Act, (which

98 See SSM Manufacturing v Snell (1997) 1 CCMA.
99 See NUMSA & Another v Success Panelbeaters & Service Centre t/a Score Panelbeaters & Service Centre (1999) 20 ILJ 1851 (LC).
implies that the contract of employment terminates automatically upon the insolvency of the employer).

An urgent legislative overhaul of section 197 was required. In the meantime transferors and transferees of businesses, as well as Unions and employees, have to be satisfied with the hesitant, case-by-case development of the issues concerned by our courts and the CCMA.

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CHAPTER 4

AMENDMENTS TO SECTION 197

4.1 INTRODUCTION

Few provisions of the current Labour Relations Act have created more confusion and uncertainty that opaque wording of the current section 197. The purpose of that section, which was borrowed from foreign shores and crudely worked upon to suit South African conditions, was to strike the elusive balance between protecting jobs and ensuring that businesses could still follow the natural tendency that some have in a free enterprise economy to go under, be taken over, to sell or merge. The drafters tried to ensure that. When any of these fates befall a solvent company, its employees will move over to the new entity, taking the benefits of their past service with them. The current statutory provisions intended to serve these objectives in a tangle of ambiguous cross-references that has created a dream for imaginative lawyers and a nightmare for judges and employers.\(^{101}\)

The legislature has taken to heart the judicial criticism of the present section 197, which has been extensively recast in the Labour Relations Bill 2000. The new version splits the provisions of transfers in circumstances of solvency and those affected by insolvent circumstances more clearly.\(^{102}\) The new sections 197 (regulating transfers of solvent businesses) and 197A (regulating transfers of insolvent businesses) also protect jobs far more effectively than the poorly worded predecessor in situations that might otherwise give rise to retrenchment.\(^{103}\) 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 businesses, to decide whether the new employer will take over the employees of the transferor.\(^{104}\)

\(^{104}\) See NEHAWU & Others v University of Cape Town (2002) 4 BLLR 311 (LC).
4.2 THE NEW SECTION 197

4.2.1 POLICY OBJECTIVES

The new section 197(1) regulates the employment consequences when the transfer of a business takes place. This is defined to mean the transfer of a business by one employer, (the old employer) to another employer (the new employer) as a going concern. Business is defined to include the whole or part of the business, trade undertaking or service. Like the current provision the new provision refers to the transfer of a business. It is therefore a wider concept than the sale of a business.\(^\text{105}\) No attempt is made to define what constitutes a “going concern” and the controversial issue of whether an outsourcing exercise can constitute a going concern transfer is not explicitly dealt with. The fact that a business is defined to include a service may be an indication that it was intended to typify outsourcing as a going concern transfer, but this is not necessarily the case.\(^\text{106}\)

The new section 197 provides that whenever a business or part of the business is transferred as a going concern, then the new employer is automatically substituted in the place of the old one, and all the rights and obligations of employees within the business pass over automatically as well.\(^\text{107}\) The primary intent of the new provision is to afford job continuity and equivalent terms to employees who would otherwise have been exposed to insecurity and disadvantage because of limitations in the common law and now it seems (following the decision in \textit{NEHAWU & Others v University of Cape Town & Others},\(^\text{108}\) the old section 197 as well. The continuity of the collective agreement is also preserved.\(^\text{109}\)

The new section 197 seeks to bring some clarity to a very confused situation. The amendments begin by defining the elusive term “transfer of a business as a going concern”. This says, the amendment, is the transfer of an economic entity,


\(^{106}\) \textit{Supra} ft 82.

\(^{107}\) Labour Relations Amendment Act, 2002; s197(2)(a)(b).


\(^{109}\) Labour Relations Amendment Act, 2002; s197(5)(6).
consisting of an organised grouping of resources that the objects of performing an economic activity”, provided that this entity retains its identity after the transfer. Whether this definition will provide much assistance in the real world is doubtful. An “economic entity” is difficult to identify. It is hard to imagine one that does not consist of an organised grouping of resources, unless one includes that many entities that are, in fact, thoroughly disorganised and presumably headed for insolvency.\textsuperscript{110}

The requirement that an entity must perform and economic activity seems superfluous, unless the intention is to distinguish entities normally termed “businesses” from such entities such as churches, welfare agencies and the like. The requirement that the economic entity must retain its “identity” after the transfer also invites debate, especially in the context of a merger when the entity that has taken over simply absorbed into a greater entity. One can say with reasonable certainty that the courts will continue to fall back on the time-honoured test they use to identify whether the transfer of a business has taken place under the current Act and the common law – namely, to ask tautologically whether the dominant impression reached after considering all the factors indicates that the transfer of a business has taken place.\textsuperscript{111}

### 4.3 CONSEQUENCES OF A TRANSFER

Section 197(2) regulates the consequences of such a transfer. It states that if a transfer of a business takes place, unless otherwise agreed, the following occurs:

- The new employer is automatically substituted in the place of the old in respect of all contracts of employment in existence immediately before the date of transfer.\textsuperscript{112}

- All 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 the employee.\textsuperscript{113}

- 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 an act of unfair discrimination, will be considered to have been done by, or in relation to the new employer.\textsuperscript{114}

- The transfer does not interrupt an employee’s continuity of employment.\textsuperscript{115}

The intention is to place the transferred employees in the same position vis-à-vis the new employer as if they were vis-à-vis the old employer. Not only the rights and obligations arising from the contracts of employment, transferred,\textsuperscript{116} but also the rights and obligations between the parties.\textsuperscript{117}

The new employer also becomes liable for any alleged unfair dismissial, unfair labour practice and, or act of discrimination committed prior to the transfer by the old employer. Continuity of employment and the rights associated therewith remain unaffected by the transfer. It is also clear that the section binds both the employees and the employers concerned, unless otherwise agreed. The controversy reflected in the \textit{Foodgro} and the \textit{University of Cape Town} decisions is thus resolved. It is specifically provided that criminal liabilities are not transferred from the old employer to the new employer.\textsuperscript{118}

In cases where only part of a business is being transferred it may be difficult to determine which employees are associated with that part of the business. This will be a question of fact and, in the case of uncertainty; it may be wise to seek agreement from the employees concerned. It is also important to note that all employees that are associated with the business (or part thereof) are transferred and, in the absence of an agreement with the relevant employees, it will not be

\textsuperscript{113} S197(2)(b).
\textsuperscript{114} S197(2)(c).
\textsuperscript{115} S197(2)(d).
\textsuperscript{116} S197(2)(a).
\textsuperscript{117} S197(2)(b).
\textsuperscript{118} S197(10).
possible to transfer only some of the employees. The section recognises that the new employer may face difficulties in placing its newly acquired employees in exactly the same position they had enjoyed with the old employer.

Section 197(3)(a) states that there will be compliance with section 197(2) if the new employer provides terms and conditions that are “on the whole not less favourable” to the transferred employees than those that they had enjoyed with the old employer. This envisages that the new employer will be entitled to provide employment on the basis that certain terms and conditions are less favourable to the employees, provided that the “total package” is, on the whole, not less favourable.

The flexibility provided by this provision is significantly dissipated by section 197(3)(b), which states that this does not apply to employees if any of their terms and conditions of employment are determined by a collective agreement. This prohibition will apply even if a collective agreement determines some, but not all, of the terms and conditions of employment of the employees concerned.

An interesting question whether a collective agreement which sets minimum terms and conditions of employment will prevent the operation of section 197(3)(a) in circumstances where the employees concerned enjoy terms and conditions that are more favourable than those found in the collective agreement. It is submitted that it will not apply because the collective agreement does not, in reality, determine the conditions of employment of the employees concerned. However, the element of flexibility provided would not permit the new employer to provide less favourable terms than those set out in the agreement.

4.4 TRANSFER OF THE CONTRACTS OF EMPLOYMENT

If conditions or circumstances of work are substantially less favourable, employees could have a claim for constructive dismissal should they resign as a result of such a situation. Work practices can change, but should not be less favourable. No exact replica of the employment contract is required, if the terms and conditions of employment are on the whole no less favourable. Transfers to pension, provident and retirement funds are permitted. Where employment conditions are regulated by
collective agreement, then the “on the whole no less favourable” relaxation does not apply. It would appear that the very same terms and conditions must be maintained.

4.5 GOING CONCERN

As the case with the current section 197, the new section 197 will only apply to the transfers of businesses as a going concern. A business is defined to include “the whole or part of any business, trade, undertaking or service”.\textsuperscript{119} The reference to the concept of a “service” in the definition was apparently inserted at the insistence of COSATU,\textsuperscript{120} to ensure that most, if not all, outsourcing operations as regarded as transfers of a business as a going concern. Whether this will achieve its purpose remains to be seen. It is at least arguable that it will not. The mere fact that a “service” is included within the definition of a business does not necessarily mean that a business will be transferred as a going concern. This will probably remain a question of cold fact.\textsuperscript{121} A business is a going concern only if its assets, moveable and immovable, tangible and intangible, are utilised in the production of profit (or) the attainment of its goals. Where the seller of the purchaser don’t intend that the employees should go across, there is not transfer of a business as a going concern, and the provisions of section 197 don’t apply. Accordingly the section 197 protections and obligations will only come into play where the purchaser intends in the first place to take over employees as part of the purchased business.

4.6 OUTSOURCING

The amended section 197 makes no direct reference to outsourcing. There is a common misconception that section 197 applies only to sales of businesses. In Europe as in South Africa, forms of employment have changed in the last decade or so.

A focus on core functions has led to the establishment of a core workforce and a

\textsuperscript{119} S197(a).
\textsuperscript{120} Council of South African Trade Unions.
penumbra of atypical employment relationships in a variety of forms. These include temporary employees, casual employees, part-time and home workers and persons who provide a service either themselves or who are employees of a service provider and to whom a function has been outsourced. In the broad sense outsourcing is a form of divestment of a management function to a third party. The basis on which the divestment takes place is crucial to a decision on the application or otherwise of section 197. In recent years outsourcing has become common practice that it has developed into a major industry in South Africa. Large and small enterprises, government departments, local authorities and other employer have outsourced functions such as payroll, cleaning and catering. The reasons for outsourcing are many and varied. However contractors looking for work have up to now been prepared to take all these burdens off the shoulders of their clients in return for the often-lucrative income which this may bring. The amended Labour Relations Act has put a spanner in the works for the outsourcing industry. Even under the old LRA, the Labour Court had begun to place serious limits on the outsourcing deals carried out.\(^{122}\)

While in some cases of outsourcing there is a contractual nexus between the transferor and the transferee, this is not an essential condition for the application of a transfer of undertaking provision. What is key is whether a changeover in management has occurred.\(^{123}\) A going concern is a bundle of physical assets including buildings, machinery, vehicles and IT hardware. Intangible assets include business process and systems, brand intellectual capital, goodwill and supply relationships. Other assets may include human resources (employees), contractors, advisors and consultants. The more readily it can be said that the employer hands over the full business bundle, the more one can talk of a business transfer. Conversely the employer hands over nothing except a business opportunity, and contracts in a service (pays for an externally supplied activity), the case for a section 197 looks weak in terms of outsourcing.

In *SAMWU v Rand Airport Management Company*, the company wished to outsource the security and gardening services. These were non-core services. The gardening service was not an entity. It had not separate management structure, no own goals, no assets, no customer and no goodwill. It was merely an activity. The function was to be outsourced for a limited period only. Landman J held as follows:

“Where the seller and purchaser of the business in question don’t intend that the employees should go across, there is no transfer of a business as a going concern, therefore the provisions of sections 197 do not apply.”

As can be seen from the above the *NEHAWU* interpretation still holds good for the amended section 197.

### 4.7 INSOLVENCY

Like the present provision, the new one provides that the transfer of an insolvent business results in the automatic transfer of the contracts of employment to the new employer. However, the rights and obligations between the solvent and the insolvent employer and its employees remain between the employees and solvent employer, except that the insolvent and the new employer become jointly and severally liable for the discharge of these obligations. If the contracts of employment are transferred, continuity of employment is not interrupted, subject to its suspension in terms of section 38 of the Insolvency Act. As the latter proviso indicates, the key to understanding this amendment lies in the amendment to section 38 of the Insolvency Act. Currently, that section has the effect of automatically terminating the contracts of employment of a company once it has been sequestrated. This means that the termination of the contracts of employment to a dismissal in terms of the Labour Relations Act. The result is to deprive such employees from the protections against unfair dismissal. The amendment provides that the sequestration of a company merely “suspends” the contracts of employment of the sequestrated employer.

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126 Cheadle et al 13th Annual Labour Law Seminar slide presentation.
127 Act 24 of 1936.
128 See *SAAPAWU v HL Hall and Sons (Group Services) & Others* (1999) 2 BLLR 164 (LC).
Anything done “by or in relation to the old employer”, including the dismissal of an employee, before the transfer shall be considered to have been done “by or in relation to” the new employer. This means that if the old employer dismisses an employee prior to the transfer, the new employer will be deemed to have undertaken the dismissal. However, the precise effect of this provision remains unclear, at least in certain circumstances. Various possibilities exist in this regard.

The first is where the CCMA makes an award, or the Labour Court hands down a decision, to the effect that there was an unfair dismissal, and grants remedy to the dismissed employee, prior to the transfer of the business. The arbitration award or Labour Court judgement will bind the old employer and can therefore be enforced against that employer. Section 197(5) states that the new employer is bound by the arbitration award which bound the old employer immediately prior to the transfer. The award will therefore be enforceable against the new employer.

Interestingly, there is no similar provision dealing with decisions of the Labour Court, given the same circumstances. The question is whether this was the intention of the legislature or merely an oversight. The latter is more likely as there seems to be no reason why a Labour Court decision should not be dealt with in the same way as an arbitration award. Section 197(2)(b) can be interpreted to achieve the same purpose. The court’s decision could be said to create “rights” and “obligations” between the old employer and the employee as envisaged in section 197(2)(b) and this would have the effect of making the court order enforceable against the new employer. The dismissal will be considered to have been undertaken by the new employer.

The award, however, cannot be forced on the new employer after the transfer has taken place. The intention of section 197(9), which states that the old employer and the new employer will be jointly and severally liable for any claim “concerning any

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129 S197(1)(c).
130 Commission for Conciliation, Mediation and Arbitration.
131 S197(1).
term or condition of employment that arose prior to the transfer”. This provision indicates that the legislature was of the opinion that, after the transfer, the old employer disappears from the picture and that such a specific provision was necessary to establish joint liability.

The next possibility is that the arbitration or court proceedings are completed prior to the transfer, but the award of decision was only given after the transfer. Section 197(5) only deals with arbitration awards that are binding on the old employer at the date of the transfer and does not apply to awards made after the transfer.

In the above scenarios the new employer is in an especially invidious position in that the new employer is held liable for unfair actions of the old employer in circumstances where the new employer, will in most cases, have had a role to play in the dismissal. The position may be worse if the old employer does not raise a proper defence to a case, which can be defended. It may therefore be argued that such a significant imposition of liability should only be permitted where it is explicitly authorised by the Labour Relations Act, and that an extensive interpretation relying on section 197(2)(c) should be adopted. However, given the policies underlying the LRA in general, and section 197 in particular, it is probable that the section will be interpreted in favour of dismissed employees.  

The view will probably be that the new employer has the ability to protect itself against this type of liability by taking care to investigate potential liabilities during the course of a due diligent investigation and/or the negotiation of indemnities or warranties catering for the risk. It can also occur that a dispute had been referred to the CCMA prior to the transfer but no conciliation and or arbitration or adjudication had taken place at the date of transfer.

Quite apart from the issues of enforceability, questions relating to the involvement of the old employer in the dispute process may arise. Here the employer, formerly cited in the referral form, will presumably be the old employer and the old employer, formally at least, would be the respondent. There is, however, no guarantee that the

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old employer will defend the matter with any vigour. In this situation the new employer should join the old employer as a party to the dispute.

Finally, there is the possibility that although a dismissal took place prior to the transfer, no referral took place prior to this date. It is likely that the CCMA and Labour Court will answer this question in the affirmative and that the employer cited in this case will be the new employer. It may be wise for the new employer to insist on inserting clauses in the agreement, which gave rise to the transfer of the business, which would oblige the old employer to co-operate and assist in defending any claims that the new employer may face.

4.8.1 DISMISSAL RELATED TO THE TRANSFER

The new section 187(1)(g) creates additional problems for employers in this regard. It states that a dismissal will be automatically unfair if the reason for the dismissal is “a transfer, or a reason related to a transfer, contemplated in section 197 or 197A”. This provision is just as problematic as the new section 186(f). Its purpose appears to be an attempt to limit job losses in the situation where there is a transfer of a going concern. If strictly interpreted, it could constitute a significant restriction on going concern transfers and, in the long term, destroy jobs rather than protect them. It is not unusual for an employer facing financial problems to sell off part of his business in order to save money or to provide funds, restructure other parts of the business, thus saving jobs in the long run.

Clearly this is going to be a difficult provision to apply and interpret. If the old employer is required, as a precondition to the sale of a business as a going concern, to cut costs by retrenching employees it could contravene section 186(f). On the other hand, if the old employer envisages the sale or transfer of the business some time in the future but has no fixed plans in this regard and embarks on a cost cutting exercise to make the business more attractive to the purchaser, there would probably

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133 In terms of s197(2)(b) of the Labour Relations Amendment Act 2002.
be no contravention. It is submitted that a *bona fide* decision to cut costs after a transfer will not fall foul of this provision.

### 4.9 COLLECTIVE AGREEMENTS AND ARBITRATION AWARDS

Unlike the current section 197, the new section 197 also deals with the rights and obligations that flow from collective agreements and arbitration awards. Unless otherwise agreed, any arbitration award that immediately prior to the transfer bound the old employer in respect of the employees that are transferred, will bind the new employer.\(^{135}\) This includes arbitration awards made in terms of the LRA, common law, as well as any other law. The new employer will be bound by collective agreements, which bound the old employer immediately prior to the transfer.\(^ {136}\) The general principle appears to be that the old employer will be bound by such agreements. If a collective agreement deals with terms and conditions of employment, this provision will not have significant impact. This is because terms and conditions of employment would have become part of the contracts of employment of the employees falling within its scope and these rights would have been transferred by virtue of the provisions in section 197(2). This provision will be of more importance when dealing with collective agreements, which grant rights, such as collective bargaining and organisational rights, to a union. The new employer will be bound to accord the union such rights. Typically these rights would have been granted to the union by the old employer on the basis that it enjoyed a degree of representivity within the old employer’s workplace or a particular bargaining unit. These rights will still accrue to the union even if the union does not enjoy this representivity among the new employer’s workforce.

In most cases, however, the new employer would be entitled to terminate the agreement by giving the period of notice stated in the agreement. The same would apply if the new employer were dissatisfied with the terms on which the old employer had granted the rights. Such a termination may trigger a dispute with the union, which may lead to the re-negotiation of the agreement. Failure to reach an

\(^{135}\) S197(5)(b)(i).

\(^{136}\) S197(b)(ii) and (iii).
agreement with regard to organisational rights could lead to arbitration, or the union embarking on a protected strike, provided that the provisions have been met. In the case of a refusal to recognise the union for certain purposes, the union could embark on a protected strike. In this case the strike would, in addition to the normal requirements for protected status, have to be preceded by an advisory arbitration award.

It is interesting to note that (ii) and (iii) of section 197(5)(b) refer to collective agreements binding in terms of section 23 and section 32. Section 32 regulates the binding nature of collective agreements entered into outside bargaining council agreements that are extended to so-called non-parties. The lack of reference to section 31, which provides that a bargaining council agreement is binding on the parties to the council that entered into the agreements, seems anomalous. It should be remembered that bargaining councils have jurisdiction over specific industries or sectors. It is possible that the transfer of a business, or more probably part thereof, to a different employer has the result that employees thus transferred will no longer fall in the industry covered by the bargaining council. This will mean that, despite the provisions of s 197(5), the bargaining council will not be able to enforce the agreement in respect of those employees. There is also the possibility that the transferred employees may, by virtue of this transfer, fall under the jurisdiction of another bargaining council with its own agreements. To avoid potential problems in this regard it is provided that a CCMA Commissioner, acting in terms of section 62 of the LRA, may determine that the agreement no longer applies to the transferred employees.

4.10 PENSION PROVIDENT FUNDS

One of the aspects of the current dispensation which has been most problematic in practice has been that of entitlements to pension and provident fund benefits. The new section clarifies at least one of these aspects. Section 197(4) states that a transfer does not prevent an employee from being transferred to a pension, provident, retirement or similar fund other than the fund which the employee

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belonged to prior to the transfer, if the criteria in section 14(1) of the Pension Funds Act\(^{139}\) are satisfied. This section protects the interests of employees transferring from one fund to another. The amount of money transferred to the new fund in respect of the transferring employee should be fair and the rights of employees monies accumulated in the old fund are protected.

The obligation of the employer to contribute to the fund, and the terms on which such contributions must be made, will also typically fall within the ambit of section 197(2) as this is usually regulated in the employee’s contract of employment. The issue of whether employees is entitled to receive the same benefits from the fund is also more difficult to determine and is one which will finally have to be decided by the courts. In the case of a defined contribution fund this is not an issue, as the benefit will primarily be determined by the contributions made to the fund by the employee and/or the employer and the investment returns enjoyed by the fund. However, in the case of the rapidly diminishing number of defined benefit funds the position is not clear. One argument would be that a transfer to another fund in compliance with section 14 of the Pension Funds Act is compliance for the purposes of section 197. Given the difficulties referred to above, the statutory licence to regulate the terms of the transfer of employees from old to new employer by agreement is of the greatest importance. This is regulated by section 197(6). The first point to be noted is that the agreement must be in writing. On the employer side, the agreement can be entered into by the old employer, the new employer, or both of them acting jointly. It is therefore possible for the new employer to agree with the other contracting party that less favourable terms and conditions of employment will apply in at least certain respects. In theory, there may be problems if an old employer enters into this type of agreement without a mandate from the new employer. In practice this is unlikely to happen as the agreement between the employers, which leads to the transfer as a going concern, would probably regulate this aspect.\(^{140}\)

\(^{139}\) Act 24 of 1956.

4.11 RETRENCHMENT PRIOR TO TRANSFER

The agreement of the employees to transfer to the new employer on less favourable terms and conditions of employment may be obtained by the old employer paying some form of compensatory amount to the employees. This often takes place on the basis that the employees concerned are “retrenched” by the old employer and then receive a “severance package” as an incentive. This may give rise to difficulties when, on some future date, transferred employees are retrenched. They may argue that, by virtue of the provisions of section 197(2), they have retained their seniority and that they are therefore entitled to a package calculated on the basis of their total service with the old as well as with the new employer – this notwithstanding the fact that they were fully “compensated” for their years’ service with the old employer by payment of a retrenchment package. In the Foodgro decision the Labour Appeal Court interpreted the current section 197\(^{141}\) to prevent employees from agreeing to forfeit recognition of their service with the old employer for the purposes of calculating severance benefits. The new section 197 does not seem to prevent this. However, it would be wise for employers to specifically deal with it in this agreement. On the employee side the agreement can be entered into by the “appropriate body referred to in section 189(1).\(^{142}\) This means any party with whom a retrenching employer is required to consult prior to a retrenchment. The precise requirement of s 189 with regard to whom consultation must take place is far from clear. The employer or employers participating in negotiations which may lead to such agreements must disclose to the employees or their representatives all relevant information that will allow the employees or their representatives to engage effectively in negotiations. Should the employer fail to provide such information, or should a dispute arise as to whether the information is disclosable, the provisions of section 16 of the LRA will apply.

4.12 THE NEW EMPLOYER’S WORKFORCE

An employer, which acquires new employees as a result of an section 197 transfer, may face various difficulties. For example, the new employees may be employed

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\(^{141}\) LRA 66 of 1995.

\(^{142}\) Supra ft 107 dealing with Dismissal for Operational Requirements.
under terms and conditions that differ from those enjoyed by its existing workforce. These differences may cause administrative and industrial relations problems. The working hours of the transferred employees, or their leave entitlements, may not suit the operational needs of the new employer. The employer may find that it cannot afford the terms and conditions of employment that the transferred employees enjoyed with the old employer. The new employer, nevertheless, remains bound by these terms and conditions of employment. Of course, it may be argued that the new employer entered into the agreement in terms of which it acquired a business as a going concern with open eyes and with full knowledge of its consequences. The new employer may even have factored the financial disadvantages that the transferred employees would bring about into the price it was prepared to pay for the business.

4.13 CHANGES TO TERMS AND CONDITIONS AFTER TRANSFER

The question now is whether the employer may be able to change the terms and conditions of employment after the transfer? There are at least three obstacles, which may prevent this from being done. The first is that there may be a collective agreement in force which regulates the terms and conditions of the transferred employees to the new employer and which, by virtue of section 197(5), also binds the new employer. It may be possible to terminate the agreement as indicated previously. If this is not possible, the collective agreement may be renegotiated with the union concerned. Nevertheless, the termination of the agreement by the employer will, on its own, usually not be sufficient to permit the employer to change terms and conditions of employment.

The provisions of the collective agreement will have to be incorporated into the employees’ contracts of employment and these rights and obligations would have been transferred to the new employer.\textsuperscript{143} To change these contractual terms will require the consent of the employees. A unilateral change by the employer will constitute a breach of the contracts of employment of the employees concerned and found a claim for damages. In addition, such a unilateral change would entitle the employees to require the employer not to introduce the change or, if the change has

\textsuperscript{143} By virtue of s197(2).
been introduced, to restore the old terms and conditions of employment for a period of 30 days.\textsuperscript{144} Alternatively, the Labour Court could be approached for an order requiring the employer to maintain the old terms and conditions of employment for the 30-day period. Section 186 has been amended to provide employees with a further option. This newly inserted provision states that a dismissal takes place if:

“An employer terminated a contract of employment with or without notice because the new employer, after a transfer in terms of section 197 or 197A, provided the employee with conditions or circumstances at work that are substantially less favourable to the employee than those provided for by the old employer”.\textsuperscript{145}

The employee is thus given the right in terms of this section to possibly claim constructive dismissal if the new employer provides conditions and circumstances at work which are less favourable than those provided by the old employer. It is significant that the section does not utilise the terminology of “terms and conditions of employment”, which would typically be seen as including contractual obligations. This, together with the reference to “circumstances”, would imply that we are dealing with something else in this section, presumably aspects such as the physical circumstances at work. Breaches to contractual and other obligations by the new employer would usually fall within the scope of section 186(e) - the present constructive dismissal provision. As is conventional in cases of constructive dismissal, the onus rests on the employees to prove that terms and conditions offered by the new employer were in fact substantially inferior to those under which they worked for the old employer. In such cases a safer course than resigning would be to first approach the Labour Court for a declarator.\textsuperscript{146} Clearly, if strictly applied, this provision will have ludicrous consequences and, in the least certain circumstances, may have the effect that commercial transactions will not be entered into.

**4.14 RETRENCHMENT AFTER TRANSFER**

The other problem faced by the new employer is that it may not need all the

\textsuperscript{144} In terms of s64(4) of the Labour Relations Act 66 of 1995.
\textsuperscript{145} S186(f).
\textsuperscript{146} Grogan “A Twist of Transfers. LAC Interprets Section 197” (2002) Vol 18(3) EL.
employees transferred to it. As the law stands at present, the new employer will, in principle, be able to retrench after the transfer, provided that such a dismissal can be justified on the basis of the operational requirements of the business and that a fair consultation process has been complied with. The fact the new employees may belong to a union other than that recognised by the new employer may introduce practical difficulties, but this should not cause too many problems. One aspect that would have to be considered carefully would be that of selection criteria. In so far as length of service is used as a selection criterion, the period of service that the transferred employees had with the old employer would have to be recognised by the new employer. If skills are utilised as a selection criterion, whether of their own or together with other criteria, practice has shown that problems can arise. The skills that employees utilised whilst in employment with the old employer, and the preference that this accords the employees of the new employer prior to the transfer could lead to allegations of the application of unfair selection criteria. In principle the new employer will be entitled to make such distinctions, but it would be wise to consider and motivate them in detail.

4.15 VALUING BENEFITS

The fact that the new employer is placed in the position of the old employer means that the new employer becomes liable for certain financial benefits (or prospective benefits) that have accrued to an employee at the transfer date. In an attempt to protect the interests of the employees concerned section 197 places various obligations on the old employer.\textsuperscript{147}

The old employer must agree with the new employer on a valuation, as at the date of transfer, of the following:

- The leave pay accrued by the employees to be transferred.

- The severance pay that would have been paid by the old employer in the event of a dismissal by reason of the operational requirements of the old employer.

\textsuperscript{147} S197(7)(a) of the Labour Relations Amendment Act 2002.
• Any other payments that have accrued to the transferred employees, but have not been paid to the employees by the old employer.

The old employer must also conclude a written agreement with the new employer that specifies which employer will be liable for the payments of the above amounts, and, if there is an apportionment of the liability, the terms of the apportionment.\(^\text{148}\)

The agreement must also specify what provision has been made for the payment of any of the above amounts, should the employee become entitled to such payment. The terms of the agreement must be disclosed to each employee who is transferred to the new employer.\(^\text{149}\) Finally the old employer must 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 by virtue of the above provisions.\(^\text{150}\)

What is meant by this provision is not clear. It could include inserting appropriate provisions in the commercial contract aimed at ensuring that the new employer will make, and is able to make the necessary payments.

If the old employer fails to show he has complied with the above provisions, the old employer is jointly and severally liable with the new employer to any employee who becomes entitled to a payment contemplated in section 197(7)(a). However, this liability only arises in the event of the employee’s employment being terminated on the basis of the employer operational requirements, or the employer’s liquidation or sequestration. It would not for example apply if the new employer refuses to pay the employee outstanding leave pay when the employee resigns.

There appears to be potential conflict between this provision and section 197(9), which states that the old employer and the new employer are, in any event jointly and severally liable in respect of any claim arising concerning a term and condition of

\(^{148}\) S197(7)(b) of the Labour Relations Amendment Act 2002.

\(^{149}\) S197(7)(c) of the Labour Relations Amendment Act 2002.

\(^{150}\) S197(7)(d) of the Labour Relations Amendment Act 2002.
employment that arose prior to the transfer. May obligations of the employer referred to in section 197(7)(a) will constitute terms and conditions of employment. Presumably the intention was to regulate the accrued amounts referred to in section 197(7) separately and that in section 197(9) will not apply to them.

The agreement referred to in section 197(7) is one between the old and the new employer. If the new employer is of the opinion that he or she is entitled to an amount larger than that agreed to between the two employers. The employee is not bound by the agreement. If the employee can establish an entitlement to the greater amount he or she alleges is owed, this can be recovered from the new employer.\textsuperscript{151}

\textsuperscript{151} By virtue of s197(2).
CHAPTER 5

CONCLUSION

The new section 197 remains as complex as the old. It is doubtful whether the brief attempt to describe the transfers that are covered by the section will resolve the difficult issues raised by the question of when a transfer amounts to a “transfer of a business as a going concern”. The new section removes the controversial phrase “without the employee’s consent”.

The new section 197 and 197A protects jobs far more effectively than their poorly worded predecessor in situations that would otherwise give rise to retrenchment. The original section 197 was held just before its demise to leave in tact the choice of employers who are party to sales, mergers or other forms of transfers of businesses to decide whether the new employer will also take over the employees of the transferor. The new section 197 and 197A leave no doubt that employers who are party to transfers are deprived of that choice.

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

The amended section 197 will remove any doubt that the consequence of a transfer of a business as a going concern is an automatic and obligatory transfer of the contracts of employment from the transferor to the transferee. The Labour Courts will develop their own tests for the existence of a transfer, and whether there has been a transfer of a going concern.
The inclusion of the word “service” in the definition of a business makes it more likely that the outsourcing of a particular service or function will be considered to be a transfer of part of a business as a going concern. Although each case is dependent on its own facts, and while no single factor is determinative, if the test of the maintenance of the identity of an economic entity is applied, most instances of outsourcing will inevitably be transfers subject to section 197.

The amended section 197 squarely places work security back in the forefront of the ongoing debate on the regulation of atypical forms of employment. Employers and service providers resorting to outsourcing arrangements in their quest for flexibility ignore section 197 at their peril.

The new section 197 grants employees significant new rights and does, to a certain extent, clarify important aspects of our law in this area. However, it creates new areas of uncertainty. The crucial question is, of course whether it will succeed in its aim of protecting employees from the loss of their jobs. If it makes the acquisition of failing businesses to unattractive the result could be that businesses are closed rather than sold, which would be counter productive.
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