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EMPLOYMENT ALERT

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"To be or not to be?" – in what circumstances does a business transfer as a going concern?

On 4 August 2020 the Constitutional Court handed down its latest judgment in the lengthy and protracted litigation between Tasima and the Road Traffic Management Corporation (RTMC). The judgment deals primarily with whether the transfer of the Electronic National Traffic Information System (eNaTIS) constitutes a transfer of a business as a going concern in terms of section 197 of the Labour Relations Act (*"the LRA"*).

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“To be or not to be?” – in what circumstances does a business transfer as a going concern?

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On 4 August 2020 the Constitutional Court handed down its latest judgment in the lengthy and protracted litigation between Tasima and the Road Traffic Management Corporation (RTMC). The judgment deals primarily with whether the transfer of the Electronic National Traffic Information System (eNaTIS) constitutes a transfer of a business as a going concern in terms of section 197 of the Labour Relations Act (“the LRA”).

In 2001 Tasima (Pty) Ltd was awarded a tender by the Department of Transport to provide services relating to the eNaTIS system. The system links the Department with various other parties throughout the country including all vehicle manufacturers, vehicle licencing institutions, banks and the South African Police Services. It enables the Department to regulate and administer the licensing of vehicles, driving licences, vehicle roadworthiness tests as well as the general implementation of road traffic legislation in SA.

Tasima and the Department entered into a Turnkey Agreement in terms of which Tasima would develop, implement, support and operate the system for 5 years. In May 2007 the agreement was extended on a month by month basis to 2010. In 2010 the agreement was again extended for another 5 years without the proper procurement process being followed. The Department then attempted to terminate the agreement and arrange for the transfer of the system back to the Department. This led to lengthy litigation between the parties that ended up in the Constitutional Court.

In an earlier judgment referred to as *Tasima 1*, the Constitutional Court upheld the High Court’s decision that the extension was unlawful and invalid with effect from 23 June 2015. It ordered that Tasima hand over the eNaTIS to the RTMC within 30 days of 9 November 2016 (the judgment date). Tasima failed to do so. This led to RTMC instituting urgent proceedings against Tasima to enforce the handover and to evict Tasima from the Department’s premises.

On 3 April 2017 the High Court found that in terms of *Tasima 1* the handover to RTMC should have taken place on 22 December 2016. On 3 April 2017 Tasima was evicted from the Department’s premises and RTMC took over the eNaTIS and related services that day. RTMC, however, refused to take over the Tasima employees that were rendering services in respect of the eNaTIS system, contending that the handover of the service did not fall under the ambit of section 197.

Tasima launched urgent proceedings in the Labour Court to compel the RTMC to comply with its obligations under section 197 and to take transfer of its employees that had been rendering the services. The Labour Court held that the handover ordered by the Constitutional Court in *Tasima 1* was a transfer of a business as contemplated by section 197 and that the effective date of the transfer was 5 April 2017 when the actual transfer took place.

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The Court held that the legal causa for the transfer was critical to the determination of whether there was a transfer of business.

On appeal the LAC agreed with the Labour Court that the handover fell within the scope of section 197, but it differed with the Labour Court in that it held that the effective date of the transfer was on 23 June 2015, when the agreement was declared invalid.

At the heart of the issues the Constitutional Court had to decide were RTMC’s appeal that the handover was not a transfer of a business as a going concern and Tasima’s appeal that the effective date was on 5 April 2017, when the actual transfer took place.

The issue of whether the handover of the eNaTIS system to RTMC resulted in the transfer of a business as a going concern culminated in a split bench with a majority of 6 judges finding that it did and a minority of 4 judges finding that it did not.

Majority judgment

The Court considered when section 197 applies. It applies in circumstances where (a) a business (b) is transferred (c) as a going concern. The Court held that the legal causa for the transfer was critical to the determination of whether there was a transfer of business. The legal causa has to first be identified before applying the factual enquiry to determine whether the jurisdictional requirements for the operation of section 197 are present.

RTMC argued that the causa was the initial Turnkey Agreement. Tasima argued that it was the order of the Constitutional Court in *Tasima 1* to handover the system and related services to RTMC. On the facts before it, the Court found that the causa was the order granted in *Tasima I*. The Court considered that after the termination

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The Court considered that the definition of a business is broad and in considering this the courts have adopted the concept of an “economic entity” defined as *“an organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective”*.

of the Turnkey Agreement post 2007, that the scope of the services provided by Tasima had expanded significantly. The initial Turnkey Agreement anticipated that Tasima would only develop the eNaTIS system and that it would be handed over as a work product on termination. No employees would transfer in respect of the initial Turnkey Agreement. The agreement however had been amended and extended after 2007 to the extent that Tasima conducted the business of operating, managing, supporting, further developing, maintaining and running the eNaTIS system. This entailed the employment of additional employees and became Tasima’s business. These amendments and extensions were preserved by the Court in the *Tasima 1* judgment. *Tasima 1* ordered the handover of the eNaTIS system and related services as they stood after 9 November 2016.

The Court then turned to the question of whether there was a “business” as contemplated by section 197. The Court considered that the definition of a business is broad and in considering this the courts have adopted the concept of an “economic entity” defined as *“an organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective”*. It was common cause that Tasima was a special purpose vehicle whose main purpose was the development and management of the eNaTIS. Furthermore, RTMC had conceded that these functions comprised Tasima’s sole business after it was awarded the contract for the provision of services in relation to eNaTIS. In these circumstances the Court found that the components of

eNaTIS that were handed over by Tasima to RTMC constituted a “business” for the purposes of section 197.

In determining whether a transfer had taken place the Court recognised that although a business, in terms of section 197, could include a service, where services are involved, what must be transferred is the business that provides the service. The Court also acknowledged that the mere termination of a service contract would not, without more, constitute a transfer in terms of section 197. It found that in this case the facts indicated the transfer of a business, not merely the delivery of a product as contended by RTMC.

The Court also dismissed RTMC’s argument, relying on English law, that as a quasi-regulator it could not take transfer of an economic entity and accordingly there could be no transfer of a business in terms of section 197. RTMC argued that section 197 was never intended to apply to a regulatory body such as itself. The Court found that section 197 applies to all transfers of business. It was also apparent from the facts that RTMC acted as a commercial enterprise, and not solely as a regulator, when operating, managing and maintaining the eNaTIS system. In addition, RTMC had a number of characteristics which qualified it as an entity connected with economic life to enable it to take transfer of a business. The Court held that the character of the entity receiving the business was irrelevant. The only qualification is that the receiving entity must be capable of being an employer.

“To be or not to be?” – in what circumstances does a business transfer as a going concern?...continued

The Court dismissed RTMC’s appeal and upheld the decision of the Labour Court and the LAC that section 197 applied as the transfer of a business as a going concern had taken place.

The Court found that a transfer entailed the movement of the business from one party to another and could take many forms. It was the substance rather than the form of the transaction that was relevant. The test for determining whether there was a transfer was whether the economic entity retained its identity after the transfer. The Court found that there was no difference in eNaTIS and related services undertaking. It was simply in different hands. As a result, the business of Tasima was “transferred” to RTMC.

The Court then considered whether the business was transferred as a “going concern”. The primary consideration for the Court was the nature of the business. It reiterated that where services are involved, it is not the service that must be transferred, but the business that supplies the services. On the evidence before the Court, the operation, management and maintenance of eNaTIS was Tasima’s sole business. What was crucial was whether the responsibility for the operation of

the undertaking had been transferred. Since 5 April 2017, RTMC ran the entire undertaking that Tasima had previously performed. It rendered the same services that Tasima had provided as a going concern.

The Court dismissed RTMC’s appeal and upheld the decision of the Labour Court and the LAC that section 197 applied as the transfer of a business as a going concern had taken place.

In respect of the cross-appeal, the Court found that the legal causa determines the date on which the obligation to transfer arises. Ordinarily this will be the effective date of transfer. It was however necessary to draw a distinction in exceptional cases between the date on which the obligation to transfer arises in terms of the legal causa and the effective date of transfer, especially where adherence to this approach would give rise to inequitable results and potential absurdities. In the present case a transfer date determined

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The minority disagreed with the finding that there was a transfer of business as a going concern in terms of section 197. Although also finding that it was the substance of the transaction that was paramount, it came to a different conclusion on the facts.

by the legal causa, 22 December 2016, would lead to absurdities as RTMC had not on that date been given control of the business. As such it was just and equitable that the effective date of the transfer was 5 April 2017, the date on which RTMC gained physical control of eNaTIS.

The Court accordingly upheld the cross-appeal by Tasima.

Minority judgment

The minority disagreed with the finding that there was a transfer of business as a going concern in terms of section 197. Although also finding that it was the substance of the transaction that was paramount, it came to a different conclusion on the facts. The minority also examined the 3 components that underpin section 197, namely business, transfer and going concern. It held that the terms of the Turnkey Agreement, upon completion of the project, Tasima would hand over to the Department the product being the delivery of eNaTIS. The Department provided the workspace for Tasima and owned all the assets that Tasima used when developing the eNaTIS system.

Tasima employed its own workforce to develop the system to the specifications of the Turnkey Agreement. Tasima at all material times employed and remunerated these employees to conduct its business. Its business comprised of the designing and development of information systems. In this case the eNaTIS system. The fact

that Tasima had to operate the business for 5 years did not change the nature of its business. Turnkey Agreements by their very nature contemplated agreements in which the contractor agreed to design, build and complete a facility so that it is ready for use when delivered. In essence the user only has to “turn a key” to operate the project. The fact that Tasima had to operate the system for a period of time was not novel. It was standard industry practice. It did not alter the nature of Tasima’s business. Tasima’s business was not the eNaTIS system or the operation of it. It was the development and maintenance of the system which was then the product delivered to the Department to enable it to provide services to the public. It was therefore incorrect to conclude that RTMC had acquired Tasima’s business.

Furthermore, the minority found that the Department did not transfer the public service it had to provide to Tasima. The services were provided by Tasima on behalf of the Department. The provision of the public service was not considered to be part of Tasima’s business. The Department already had an existing operational road traffic management system prior to the tender. Those workers did not transfer to Tasima. It was understood that once the eNaTIS system was up and running the Department would take it over and use its own workforce to operate it. Likewise, Tasima had its own workforce to develop the system. The minority found that none of the factors that are usually considered in

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The minority found that no transfer of a business as going concern took place.

determining whether there was a transfer of a business as a going concern applied. There was no transfer of assets, customers and employees from Tasima to the Department. Nor was there a transfer of the supply of services. All that exchanged hands was the eNaTIS system itself, a product developed by Tasima in terms of the tender that was awarded to it.

The minority found that no transfer of a business as going concern took place.

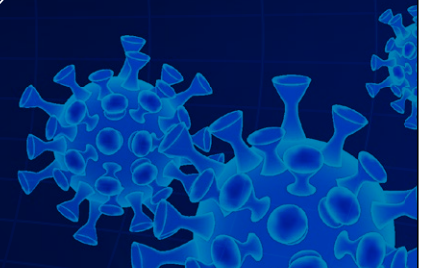
Conclusion

The split bench in the Constitutional Court highlights the difficulties in identifying whether there has been a transfer of a business as a going concern. Whether there has been a transfer must be determined carefully and based on all the available facts. There is no "one-size-fits-all" approach that can be applied.

Jose Jorge and Kara Meiring

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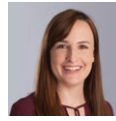
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