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AN OVERVIEW OF THE EMPLOYMENT LAW CONSEQUENCES

When a business is transferred as a going concern, the effect is that employees of that business automatically become employed by the new owner of the business, without the need for new contracts of employment between the employees and the new owner.

Under the common law, contracts of employment did not transfer automatically to a new employer when the business in which the employee served was transferred as a going concern. This was in accordance with the contractual principle that contracting parties may not assign their contractual rights and obligations to a third party without the other contracting parties' consent. However, this principle had an adverse impact on the continuity of affected employees' employment.

Section 197 of the Labour Relations Act, No 66 of 1995 (LRA) was enacted to change the common law position, with the effect that an automatic transfer of contracts of employment from the transferring employer (previous employer) to the acquiring employer (new employer) now takes place in the event that the whole or part of any business, trade, undertaking or service is transferred from the previous employer to the new employer as a going concern.

The section therefore makes provision for an exception to the principle that the contract of employment may not be transferred without the consent of the employees, and it has the dual purpose of both facilitating transfers of businesses, and protecting employees' interest in job security.

For a transaction to fall within the scope of s197, the following three elements must simultaneously be present:

- A transfer of an entity by one employer to another
- The transferred entity must be the whole or a part of a business
- The business must be transferred as a going concern

Sale of share transactions do not attract the attention of s197, as the identity of the employer remains unchanged, and hence contracts of employment remain unaffected. However, to the extent that businesses are restructured pursuant to the sale of shares, s197 may again be triggered.

What constitutes 'a business' or 'part thereof'?

'Business' is defined very widely in s197 to include the whole or part of any business, trade, undertaking or service.

Normally, one would be able to establish whether what is being transferred is a business by looking at the constituent parts of the business, and by determining which of these parts are to be divested of by the 'seller'. Not all the components of a business need to be transferred, or transferred simultaneously, for s197 to be applicable. For instance, a business may have been transferred whether or not all of the fixed assets of the business were transferred with the workforce, contracts and name.

A 'business' could have a variety of components: tangible or intangible assets, goodwill, management staff, a workforce, premises, its name, contracts with particular clients, the activities it performs, its operating methods etc. The various components that are transferred must be sufficiently linked so that it can be said that, together, they form an economic entity capable of being transferred.

It is possible that a 'business' that has no or insignificant tangible or intangible assets, but instead consists mostly of a group of workers engaged in a joint activity on a permanent basis, may constitute an economic entity capable of transfer in terms of s197.

Where a service is divested of in a piecemeal fashion for instance, with the cumulative effect being that the previous service provider is replaced by a new service provider, the transaction will be treated as a s197 transfer, irrespective of the label put on it by the parties.

Was s197 triggered when the client was compelled through intense political protest to terminate the service agreement and employ a majority of the service providers' staff?

In *Imvula Quality Protection and Others v University of South Africa* (J435/17) [2017] ZALCJHB 310 (31 August 2017) the Labour Court considered this question. The Labour Court held that s197 was not applicable.

UNISA paid a monthly fee to two service providers (two service providers) for them to provide security services which included placing staff at the UNISA campuses, providing uniforms, equipment and managing security services. After it was faced with a demand to insource the outsourced security functions, UNISA terminated the contracts of the two service providers. It then partially insourced the security function and offered employment to the majority the security staff employed by the two service providers. Although the security staff would be employed by UNISA, a new service provider was contracted with to provide its own

equipment like torches, guard tracking, uniforms and vehicles to UNISA. The new service provider would also provide managers and supervisors to manage the security service.

The two service providers alleged that s197 applied to the termination of the contracts and UNISA's offers of employment to their staff. They argued that providing security guards is a service, therefore, a business and the insourcing of the service resulted in the service's continuation. UNISA argued that s197 did not apply and that there was no transfer of a business as a going concern despite its offers of employment to the staff.

The Labour Court held that "*the termination of a service contract or the appointment of a new service provider does not in itself trigger the application of s197*".

It referred to two situations "*within the realm of outsourcing and insourcing*" identified by the Constitutional Court. In one situation s197 applies whereas in another it does not. The distinction between the situations arises due to the definition of the term 'business' in s197. The term business includes a service, however, the Labour Court held that although the definition of 'business' does include a service, it is the business supplying the service that is capable of being transferred, not the service itself.



In the first situation identified by the Constitutional Court, the right to provide the services is forfeited by the outgoing service provider but its business is not transferred. The court held that *"in this instance, the right to provide the outsourced service may transfer, but no business is transferred as a going concern."* In this situation, s197 is not applicable. In the second situation s197 applies, as in that situation when the service contract is terminated (either because the service is insourced or because there is a change in service providers) the business (and its infrastructure) supplying the service is transferred from the outgoing service provider back to the client or to the new service provider as a going concern.

The Labour Court held that the two service providers failed to show that the termination of the contract fell within the second situation. It importantly held that the two service providers had not established that

there was a transfer of a business. It held that *"[a]lthough it is not impossible for a transfer only of employees to constitute the transfer of a business for the purposes of s197, the requirement of the existence of a business must be met."*

In this case, no assets and no infrastructure were transferred from the two service providers to UNISA. Other than the employees working on UNISA contracts, the two service providers retained all remaining components making up their own businesses and could offer security services to other clients.

On Appeal, the LAC held the two service providers businesses did not just comprise of security guards. It held UNISA did not seek to run a security service and the security business at the UNISA campuses constituted more than guards patrolling the campus. The appeal was dismissed.

What constitutes a 'going concern'?

Whether the element of 'going concern' has been met, is a factual enquiry, determined objectively in the light of circumstances of each transaction, and is therefore based on the particular set of facts in question. No single factor is determinative, and the factors to be taken into account do not constitute a closed list. Factors to be taken into account include 'the transfer or otherwise of assets, both tangible and intangible, whether or not workers are taken over by the new employer, whether customers are transferred and whether or not the same business is being carried on by the new employer.' A business will not transfer if a critical component to continue with the business is not transferred.

The test for determining a 'going concern', has been described as a 'snapshot' test, where the business is compared before and after the transfer, and if sufficiently alike, will lead to the conclusion that the transfer was a going concern.

The intention of the parties (whether a transfer as a going concern is planned) is relevant but not of critical importance, moreover it is the substance, not the form, of the transaction(s) that will be determinative. Deliberate attempts to avoid the effect of s197 will not survive scrutiny, where the reality contradicts a structure employed by contracting parties.

What constitutes 'a transfer'?

Any commercial transfer mechanism may suffice, irrespective of whether it takes the form of, or is in reality, a sale of business, merger, takeover, outsourcing, exchange, donation or any other mechanism which has the effect of shifting an entity from one employer to another.

The type of transaction involved is not determinative of the question of whether there was a transfer from one employer to another. In each instance, the relevant facts must be evaluated.

In a South African context, transfers of services, whether as 'first' or a subsequent generation transfer, are likely to attract s197. Franchise agreements (termination of one franchise agreement, and subsequent replacement of the franchisee) have been held to fall outside of s197. It is, however, not the name of the transaction that is determinative, but rather:

1. 'Does the transaction concerned create rights and obligations that require one entity to transfer something in favour of/or for the benefit of another, or to another?
2. If the answer to (1) is in the affirmative, does the obligation imposed with the transaction contemplate a transferor who has the obligation to effect a transfer or allow a transfer to happen and a transferee who received the transfer?

If the answer to the second question is in the affirmative, then the transaction constitutes a transfer for the purposes of s197.'

Which employees will be transferred?

Where a part of the business is being transferred it becomes difficult to determine whether employees form part of the 'business'.

There is no South African authority on this issue. However, based on international trend, relevant considerations should include:

- Which cost centre pays the employee's cost
- How much time the employee spends on the business (or part thereof)
- Whether the employee(s) allocated to the particular business unit form a coherent grouping
- The amount of value given to the business by the employee
- The terms of the employee's contract of employment

Employee rights

The primary protection afforded to employees in s197 is the right to continuity of employment. This was given expression in s197. A dismissal for a reason related to a transfer of a business as a going concern will constitute an automatically unfair dismissal in terms of s187(1)(g) of the LRA, which will result in the more onerous remedies associated with automatically unfair dismissals being available to the successful employee.

The new employer is automatically, without the need to consult or obtain consent from any parties, substituted in the place of the previous employer in respect of all contracts of employment. All of the rights and obligations (whether contractual or otherwise) that existed between the previous employer and the employees, will continue in force against the new employer. Actions taken by the previous employer before the transfer (including the unfair dismissal of an employee who would otherwise have been transferred) will be considered to have been done by the new employer.

Employees of the transferred business who were dismissed prior to the transfer, can therefore claim reinstatement to the transferred business (and even compensation from the new employer) insofar as their dismissals were unfair.

Despite the statutory obligation that the new employer be substituted for the previous employer, as a contracting party to the employment contract, the new employer will nonetheless still comply with the requirements of s197 if it transfers employees on terms and conditions that are on the whole not less favourable to the employees than those on which they were previously employed. In the same vein, the new employer may transfer the employees to a different pension, provident, retirement or similar fund, if the criteria in s14(1)(c) of the Pension Fund Act, No 24 of 1956 are met.

The new employer's ability to unilaterally replace existing contractual terms with 'terms which are on the whole not less favourable' does not, however apply to any terms and conditions of service contained in a collective agreement – such terms and conditions must be applied exactly as contained in the collective agreement.

Unless otherwise agreed, the new employer will be bound by any arbitration awards made in terms of the LRA, the common law or any other law, as well as any binding collective agreements.

It is open to the parties to agree to contract out of the aforesaid employee protections. However any attempt to contract with a transferred employee to the effect that prior service to the previous employer will be disregarded, will be *pro non scripto* and hence unenforceable. Such agreements must be in writing, and must be entered into between at least one of the previous or new employers (or both) and the employees, as well as any person or body (such as a trade union) that the employer must consult with in an operational requirement dismissal context.

Section 197 introduces some formalities for the commercial partners in the transfer of the business, non-compliance with which may result in post-transfer liabilities

for previous employers. The previous and new employers must agree on a valuation (as at the date of transfer) of various amounts due to employees, such as accrued leave, severance pay that would have been payable, and any other unpaid amounts that have accrued to employees. The two employers must also agree which employer is liable to pay these amounts, and what provision is being made for such payment. If they agree to apportion the liability, the terms of the apportionment must be agreed. The terms of the agreement must be disclosed to all transferred employees.

If the previous employer fails to meet the obligation to reach this agreement with the new employer, the previous employer will be jointly and severally liable with the new employer, for a period of 12 months after the transfer, should any of the listed accrued dues become payable.

In addition, the previous and new employers are jointly and severally liable for any claim concerning any term or condition of employment that arose prior to the transfer.

Information and consultation

The transferred employees need only be consulted on the transfer, and the terms and conditions of employment thereafter, if the previous and/or new employer wants to contract out of the protections afforded employees

in terms of s197. Such consultation cannot result in a unilateral implementation of the employers' position – it is only possible to deviate from s197 by agreement. As previously stated, it is not possible to agree that the transfer will interrupt the employee's term of service – the years of service with the previous employer cannot be nullified.

Agreements where employees consent to deviate from s197 must be in writing, and must be entered into between at least one of the previous or new employers (or both) and the employees, as well as any person or body (such as a trade union) that the employer must consult with in an operational requirement dismissal context.

In any negotiations to conclude an agreement to contract out of s197's protections, the employer or employers concerned must disclose to the person or body concerned all relevant information that will allow it to engage effectively in the negotiations.

The terms of the written agreement between the previous and new employers that regulate which employer is liable for the amounts that had to be valued and agreed (as previously stated), must also be disclosed to any new employees who become employed by the new employer after the transfer.

Unless otherwise agreed the new employer will be bound by any arbitration awards made in terms of the LRA, the common law or any other law, as well as any binding collective agreements

Second generation outsourcing

Outsourcing transaction (irrespective of the 'generation') is likely to attract s197.

Some uncertainty existed in our law regarding the applicability of s197 to second and further generation outsourcing transactions which has been definitively resolved in a series of recent cases, most notably *Aviation Union of SA and Another v SAA (Pty) Ltd and 2 Others* [2011] 32 ILJ 2861 (CC).

The same test to be used for general commercial transactions applies (as set out previously) to the so-called second generation outsourcing transactions, and the determinative factor is (again) not the name of the transaction, but its effect. When determining whether a subsequent generation transfer should be considered a s197 transfer, the initial transfer transaction will (although not determinative in and of itself) be scrutinised. Such an initial transaction may well contain provisions that are indicative of the parties' intention for the business going forward, such as provisions retaining the previous employer's right to replace the service provider in future with a third party. There is no absolute requirement that the initial transaction, which resulted in a service being rendered by an external entity, should have constituted a s197 transfer for subsequent dealings with such service to restart under s197.

In addition, the conduct of the parties, as well as the current transaction documents (at the time of a subsequent transfer) will also be analysed to determine whether s197 is applicable.

Transfers of contracts of employment in circumstances of insolvency

Section 197A of the LRA applies to a transfer of a business if the previous employer is insolvent, or if a scheme of arrangement or compromise is being entered into to avoid winding-up or sequestration for reasons of insolvency.

Despite the Insolvency Act, No 24 of 1936, if a business is transferred in insolvent circumstances, the employees employed in that business will follow the business, and the new employer is automatically substituted in the place of the previous employer.

Should the transfer take place under these circumstances, employees will retain the contractual terms and conditions they enjoyed prior to the transfer (or at least on the whole not less favourable), but the rights and obligations that existed between them and the previous employer, before the transfer, will remain only between them and the previous employer, and will not transfer to the new employer. Similarly, anything

done by the previous employer, prior to the transfer, will be considered to have been done only by the previous employer, and the new employer will bear no responsibility for same.

It remains impossible however to nullify past years of service, and this cannot be changed, even by agreement.

The new employer may transfer the employees to a different pension, provident, retirement or similar fund, if the criteria in s14(1)(c) of the Pension Fund Act are met.

Unless otherwise agreed, the new employer will be bound by any arbitration awards made in terms of the LRA, the common law or any other law, as well as any binding collective agreements. Accordingly, terms and conditions of service contained in a collective agreement must be applied exactly

as contained in the collective agreement, and the new employer will not be able to apply 'on the whole not less favourable terms' unless an agreement to the contrary is reached with the employees. Such agreement must conform to the same requirements of negotiation and information sharing as is the case with normal s197 transfers.

The s197 obligations that rest on the two employers, to agree to certain valuations and make provisions for payments, do not apply to transfers that fall under s197A, and neither will any joint and several liabilities arise.

Disclosure of information concerning insolvency

An employer that is facing financial difficulties that may reasonably result in the winding-up or sequestration of the employer, must advise a consulting party (any person or body, such as a trade union, that the employer must consult with in an operational requirement dismissal context) of these financial difficulties.

An employer that applies to be wound up or sequestrated, whether in terms of the Insolvency Act or any other law, must at the time of making such application, provide the aforesaid consulting parties with a copy of the application. Similarly, if the employer receives an application for its winding-up or sequestration from a third party, it must supply the relevant consulting party with a copy of such application within two days of receipt thereof, or within 12 hours, if the application is brought on an urgent basis.

The Companies Act, No 71 of 2008 also requires that, in certain circumstances, notice be given to all 'affected persons' of the company's financial distress. The term 'affected person' includes registered trade unions representing employees of the company, and if any of the employees are not represented by a registered trade union, then to each

of those employees or their respective representatives. An example of a circumstance in which the board has a statutory duty to disclose information to employees is where the board of a company resolves to begin business rescue proceedings.

If it adopts and files such a resolution, it has to notify all affected persons within five business days that the resolution was adopted. It must also furnish a sworn statement of the relevant facts. Thereafter, the company must periodically provide information relating to the business rescue process to affected persons, including the identity of the business rescue practitioner.

Affected persons have various rights of participation in business rescue proceedings, including launching court applications to set aside resolutions commencing business rescue, setting aside the appointment of a business rescue practitioner, and participating in consultations

regarding the business rescue plan, voting on the business rescue plan, and proposing an alternative plan if the practitioner's plan is rejected.

A company that objectively finds itself in financial distress as defined in the Companies Act, but fails to resolve to place the company in business rescue, must also give notice to affected persons (including the employees, their trade unions and other representatives) of such fact, setting out the criteria that indicate that the company is in financial distress, and its reasons for not adopting a business rescue resolution.

The Companies Act further confers another business rescue related right to access to information on trade unions, in s31. Trade unions must, through the intervention of the Companies and Intellectual Properties Commission (CIPC), be given access to company financial statements for purposes of initiating a business rescue process. This access can be made subject to conditions imposed by the CIPC.

It remains impossible to nullify past years of service and this cannot be changed even by agreement

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Our Employment Law team is externally praised for its depth of resources, capabilities and experience.

Chambers Global 2014–2023 ranked our Employment Law practice in Band 2 for employment. *The Legal 500 EMEA 2020–2023* recommended the South African practice in Tier 1, and our Kenyan practice in Tier 3 for employment.

The way we support and interact with our clients attracts significant external recognition.

Aadil Patel is the Practice Head of the Employment Law team, and the Joint Sector Head of the Government & State-Owned Entities sector.

Chambers Global 2015–2023 ranked him in Band 2 for employment. *The Legal 500 EMEA 2021–2023* recommended Aadil as a leading individual for employment and recommended him from 2012–2020.

The Legal 500 EMEA 2021–2023 recommended **Anli Bezuidenhout** for employment.

The Legal 500 EMEA 2020–2023 recommended **Jose Jorge** for employment.

Chambers Global 2018–2023 ranked **Fiona Leppan** in Band 2 for employment. *The Legal 500 EMEA 2022–2023* recommend her for mining. *The Legal 500 EMEA 2019–2023* recommended her as a leading individual for employment, and recommended her from 2012–2018.

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Chambers Global 2021–2023 ranked **Imraan Mahomed** in Band 2 for employment and in Band 3 from 2014–2020. *The Legal 500 EMEA 2020–2023* recommended him for employment.

The Legal 500 EMEA 2023 recommended **Phetheni Nkuna** for employment.

The Legal 500 EMEA 2022 recommended **Desmond Odhiambo** for dispute resolution.

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The Legal 500 EMEA 2023 recommended **Thabang Rapuleng** for employment.

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