

# Transfer of businesses as going concerns: The over-protection of employees under insolvent circumstances<sup>1</sup>

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## OPSOMMING

### Oordrag van besighede as lopende ondernemings: Die oorbeskerming van werknemers onder insolvente omstandighede

Die arbeidsreg beskerm werknemers wanneer besighede as lopende ondernemings oorgedra word. Die nuwe werkgewer moet alle werknemers se dienskontrakte oorneem en geen werknemer mag tydens die oordragsituasie ontslaan word nie. Die gewysigde Insolvensiewet bevorder die konsep van besigheidsredding ("business rescue"). Kurators en trustees van insolvente ondernemings word aangemoedig om besighede as lopende ondernemings te verkoop. Ingevolge arbeidsregbeginsels word kopers van insolvente besighede egter verplig om alle dienskontrakte oor te neem. Hierdie alles-of-niks beginsel hou egter die moontlikheid in dat kurators en trustees eerder die opskortings-tydperk van dienskontrakte sal laat uitloop, met gevolg dat alle dienskontrakte deur regswerking ingevolge die Insolvensiewet beëindig sal word. Hierdie toedrag van sake kan negatiewe gevolge inhou. Die onlangse Arbeidsappèlhofsaak, *SA Municipal Workers Union v Rand Airport Management Co (Pty) Ltd*, bevestig dat beide verkopers en kopers van lopende ondernemings uiters versigtig moet wees om enige dienskontrakte voor of na sodanige oordrag weens operasionele redes te beëindig. Daar word in hierdie bydrae geargumenteer dat hierdie beskermingsmaatreëls uiteindelik tot werknemers se nadeel sal strek, aangesien werkgewers eerder werknemers weens finansiële redes sal afdank as om die moontlikheid te ondersoek om besighede in die geheel of gedeeltelik as lopende ondernemings te verkoop.

## 1 Introduction

When an employer is faced with severe financial difficulties, the question may arise as to what extent labour law continues to offer employees protection even though the employer may have become insolvent. "Actual insolvency" of an employer entails the factual situation where the employer's debts exceed his or her assets,<sup>2</sup> whereas "commercial insolvency"

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1 Some of the views expressed in this article were first stated by Van Eck, Boraine and Steyn "Fair Labour Practices in South African Insolvency Law" 2004 *SALJ* 902-925. This contribution builds on (and extends) most of the initial arguments raised in the above article against the background of recently reported case law.

2 In *Venter v Volkskas Ltd* 1974 3 SA 175 (T) it was confirmed that the balance sheet test is used to determine whether the debtor's liabilities exceed his or her assets.

refers to the situation where the employer has cash flow problems and is unable to pay debts, but where his or her assets still exceed his or her liabilities.<sup>3</sup> From a labour law perspective, there is nothing that precludes an employer from continuing operations under insolvent circumstances. It is common cause that labour legislation hardly makes reference to the legal disposition of insolvent employers. However, from a business perspective, it would be nonsensical for any individual or entity to continue pouring time and energy into an undertaking if there is no prospect of future profits.<sup>4</sup>

An employer could consider the possibility of trading a business out of insolvency in order to enter a profitable margin once again. In the process, the employer could solicit new business or implement improved business practices. However, the growing of a business under these financially restrictive circumstances is no easy task. In most instances, employers would rather opt to place their floundering businesses through a combined cost-cutting and restructuring exercise.<sup>5</sup> This often results in the dismissal of employees on operational grounds.

During the process of terminating contracts of employment on grounds of operational requirements, the sale (or outsourcing) of portions or the whole of the business is an aspect that is often placed on the consultative agenda. The Labour Relations Act ("LRA")<sup>6</sup> recognises the employer's right to dismiss employees on grounds of operational requirements but protects employees on two fronts during restructuring: (a) they are protected against unfair dismissal<sup>7</sup> and (b) they may not be dismissed when a business is transferred as a going concern.<sup>8</sup> It is submitted that employers enter murky waters when they suggest a transfer of the whole or part of the business as an alternative to an operational requirements dismissal. In such cases, it is problematic to determine whether dismissal occurred on grounds of operational requirements (which is permissible), or for reasons related to the transfer of the business or a part thereof as a going concern (which is not permissible).

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3 Fourie "Feitelike insolvensie en handelsinsolvensie" 1980 *THRHR* 298.

4 However, it could be argued that commercial considerations are most often one-sided in nature and do not sufficiently reflect considerations such as basic human rights (including the right to fair labour practices), social security and corporate responsibility. Therefore, the argument could continue, there is an indispensable necessity to blunt the harsh effects of pure commercial interests by providing legislative protection to fragile interest holders in the world of work, namely employees.

5 See eg Thompson "Bargaining, business restructuring and the operational requirements dismissal" 1999 20 *ILJ* 755; Rycroft "The evolving (but confusing) law on business restructuring" 2003 24 *ILJ* 68; Du Toit "Business restructuring and operational requirements dismissals: *Algorax* and beyond" 2005 26 *ILJ* 595.

6 Act 66 of 1995.

7 *Idem* s 188(1)(a)(ii) recognises that an employer may dismiss employees "based on the employer's operational requirements", but ss 189 and 189A describe the procedures to be followed in order to prevent such dismissal from falling under the category unfair dismissal.

8 *Idem* ss 197, 197A and 187(1)(g).

In *SA Municipal Workers Union v Rand Airport Management Co (Pty) Ltd*<sup>9</sup> the Labour Appeal Court recently reaffirmed employee rights in the transfer situation.<sup>10</sup> However, as will become apparent later in this article, the question can be posed whether these workers' rights do not go too far in protecting employees' interests – especially in the instance of the insolvency of the employer. In an attempt to stimulate thought on the subject matter, the facts of the *Rand Airport Management* case, which serves as a typical case study, will be separated from comments on its decision by a discussion of both labour and insolvency law principles.

## 2 Facts of the *Rand Airport Management* Case

The facts can be summarised as follows: the employer operated and managed the Rand Airport. The employer experienced financial difficulties, and it contemplated cost-cutting measures. The extent of the employer's financial difficulties is not mentioned and it is not known whether the employer was factually or commercially insolvent. Rand Airport Management conducted several meetings with its employees during 2002, discussing different possibilities to avert or limit their dismissal, including the outsourcing of non-core activities. Without reaching agreement on it with the workers, the employer informed the registered trade union SAMWU that the non-core security, gardening and cleaning services would be outsourced. The employer reached an outsourcing agreement with a third party in respect of the gardening services. When SAMWU asked the employer about the status of the gardening staff, the employer replied that it did not know if the new employer would guarantee jobs to all gardening staff but that it was retrenching all members of the gardening staff. SAMWU applied for an urgent order declaring that the outsourcing exercise be declared a transfer as contemplated in section 197 of the LRA.

The Labour Court per Landman J<sup>11</sup> held that the outsourcing of the gardening services did not constitute the transfer of a business as a going concern and dismissed the application. It was against this decision that the union appealed to the Labour Appeal Court. The union won the proverbial battle, but lost the war in this legal wrangle. Davis AJA overturned the decision of the Labour Court and held that if the outsourcing contract with the third party had been implemented, the transfer would have constituted the transfer of a business as a going concern resulting in the transfer of all employees to the new employer. However, by choice of the

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9 2005 26 ILJ 67.

10 The most prominent cases, apart from the *Rand Airport Management* case, where employee rights during the transfer of businesses as going concerns have been upheld, are: *Schutte v Powerplus Performance (Pty) Ltd* 1999 20 ILJ 655 (LC); *Foodgrow, a Division of Leisurenet Ltd v Keil* 1999 20 ILJ 2521 (LAC); *Success Panel Beaters & Services Centre CC v NUMSA* 2000 6 BLLR 635 (LAC); *NULW v Barnard NO (Vittmar Industries (Pty) Ltd)* 2001 9 BLLR 1002 (LAC); *National Education Health and Allied Workers Union v University of Cape Town* 2003 24 ILJ 95 (CC).

11 *SA Municipal Workers Union v Rand Airport Management Co (Pty) Ltd* 2002 23 ILJ 2304 (LC).

contracting parties, the outsourcing agreement between the old employer and the third party (new employer) never came into effect, and the court could consequently not make an order that all employees must be transferred to the new employer.<sup>12</sup> Before returning to a discussion of the judgment in the *Rand Airport Management* case, it is necessary to trace the background of protective measures in favour of employees who are dismissed on operational grounds.

### 3 Creating the Appropriate Balance

Labour Law endeavours to create a more equal balance between the strong and the weak. Employers most often have assets, intricate contracts and money to pay their lawyers, while employees have laws protecting them against oppressive conditions of service and unfair dismissal. Labour law offers protection to employees whenever dismissal on grounds of operational requirements is considered or when the transfer of the whole or a part of the business is contemplated. This is in line with one of the underlying philosophies of labour law, namely to infuse some form of fairness that would curb exploitation in the relationship where employees are, in most instances, in a subordinate bargaining position *vis-à-vis* their counterpart employers.

Commencing with operational requirement dismissals, it is well known that apart from having been granted a right to severance pay in terms of labour legislation,<sup>13</sup> the right of employers to terminate contracts of employment with the normal one month written notice period,<sup>14</sup> has been made ineffective by the statutory induced requirements of "fairness".<sup>15</sup> Despite the fact that the granting of such notice period may be "lawful" in a contractual sense, it must also comply with the requirements of both substantive and procedural "fairness" in terms of the LRA.<sup>16</sup>

For employers, adherence to the requirements of procedural fairness could be a cumbersome, technical and lengthy road to follow. This is especially so after the 2002 amendments to the LRA<sup>17</sup> in respect of large-scale retrenchments.<sup>18</sup> In addition to consultations on a prescribed list of

12 From this it is clear that SAMWU may have made a tactical error in lodging the application before the implementation of the agreement to transfer the gardening services. The union should rather have waited for the transfer to occur and to initiate proceedings based on s 197 of the LRA only in the event of the new employer failing to take over all contracts of employment.

13 S 41(2) of the Basic Conditions of Employment Act 75 of 1997 ("BCEA").

14 *Idem* s 37(1)(c).

15 *Idem* s 37(6)(a) states that: "nothing in this section [that provides for prescribed notice periods] affects the right – (a) of a dismissed employee to dispute the lawfulness or fairness of the dismissal in terms of Chapter VIII of the Labour Relations Act, 1995, or any other law".

16 Ss 189 and 189A of the LRA regulate dismissal based on operational requirements.

17 Labour Relations Amendment Act 12 of 2002.

18 See Van Niekerk and Le Roux "A comment on the Labour Relations Bill 2001 and the Basic Conditions of Employment Bill 2001" 2001 22 *ILJ* 2164; Le Roux "The new law on retrenchment" 2002 11 *CLL* 101–108; Bosch "A survey of the 2002

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topics with the view of attaining agreement between the employer and a pre-determined list of interest holders,<sup>19</sup> section 189A has introduced the following safeguards in respect of large-scale retrenchments: a facilitator may be appointed with the view of assisting the parties with the above-mentioned consultation process;<sup>20</sup> the Labour Court may be approached to consider whether there are sufficient reasons for the operational requirements dismissal;<sup>21</sup> and employees have acquired the right to strike in order to deter employers from dismissing them on grounds of operational requirements.<sup>22</sup>

However, should the employer or creditors cross the bridge of trying to save the business of the employer, and sequestration or liquidation<sup>23</sup> proceedings are initiated, a completely dissimilar legal landscape emerges. A trustee or liquidator steps into the shoes of the employer and the latter takes a back seat. There is no duty on the employer to commence retrenchment proceedings in terms of the LRA. Although first the Master of the Supreme Court and then the trustee or liquidator takes over the responsibilities of the insolvent employer, it is not the underlying purpose of the sequestration process to continue the running of the business on behalf of the unsuccessful employer. The process is rather aimed at dismantling the business by establishing valid claims against the insolvent estate, determining which claims are secured and preferential, the listing of assets, terminating unexecuted contracts and making a fair distribution amongst creditors.

But what is the position if the employer, as in the *Rand Airport Management* case (or trustee or liquidator under insolvent circumstances), in order to save the whole or a part of the business, decides not to dismiss on grounds of operational requirements, but rather decides to sell or outsource a part of the business? Labour law recognises that under the common law employees “were worst off” with the transfer of any business from one owner to another.<sup>24</sup> Contracts of employment regulate a personal relationship and employees cannot be ceded from one employer to another without attaining consensus from each employee.<sup>25</sup> Consequently, at common law, a transfer would have the effect of terminating all contracts of employment with the old employer and the conclusion of

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labour legislation amendments: Is there really something for everyone?” 2003 24 *ILJ* 23; Grogan “Complicating retrenchment law: Unforeseen effects of section 189A” 2005 21(2) *EL* 16.

19 S 189(1)–(2) of the LRA.

20 *Idem* s 189A(3).

21 *Idem* s 189A(8)(b)(ii)(bb).

22 *Idem* s 189A(8)(b)(ii)(aa).

23 The term “liquidation” is used in the case of a company or close corporation. The two processes are hereinafter jointly referred to as sequestration.

24 *National Education Health and Allied Workers Union v University of Cape Town* 2002 23 *ILJ* 306 (LAC) par 12.

25 Jordaan “Transfer, closure and insolvency of undertakings” 1991 12 *ILJ* 935. In *East Rand Exploration Company v Nel* 1903 TS 42 it was held that contracting parties cannot cede interests in a contract if such interests involve a personal relationship.

new contracts of employment with the new employer.<sup>26</sup> Prior to the enactment of the LRA, the *Explanatory Memorandum to the Draft Labour Relations Bill*<sup>27</sup> stated:

“The draft Bill explicitly deals with the employer’s rights and obligations in the event of the 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.”

This citation seems to suggest that policy makers at the time were not averse to the idea of the transfer of businesses as going concerns. They rather wanted to provide protection to employees and to facilitate the transfer process. As a trade-off to the fact that contracts of employment may be transferred without first obtaining consensus from the incumbent employees, section 197 has, since the implementation of the LRA, provided that new employers must take over all contracts of employment and maintain the same terms and conditions of employment after the transfer. It appears that the legislature initially endeavoured to create a careful balance without favouring either employer or employee interests. As discussed below, this changed with later amendments.

## 4 Protection in terms of Insolvency Law

### 4.1 Prior to the 2002 Amendments

One may ask why the position under insolvent circumstances is discussed while the insolvency of the employer was not raised in the *Rand Airport Management* case. As will become clearer later in the discussion, some general statements made in the case could have a negative impact on business rescue provisions contained in the Insolvency Act (IA).<sup>28</sup>

To what extent are employee interests protected by the IA in the face of the insolvency of their employer? In the insolvency fraternity it is a well-known fact that prior to 2002 there was no job security protection for employees once sequestration proceedings had commenced. In terms of

26 Apart from the fact that the old employer would benefit from the proceeds of the sale, this would place the new employer in the position to randomly pick and choose from the ranks of the old employer – leaving the employees in a precarious situation with no job security at all. In the past, before policymakers stepped in with the LRA of 1995, one of three scenarios would typically occur in case of the sale of a business. Firstly, the buyer of the business would insist that the seller retrench employees, pay severance pay and make the sale an attractive proposition before the conclusion of the sale of the business. Secondly, the buyer would retrench superfluous employees and pay severance pay shortly after the sale and be faced with the prospects of costly litigation should the retrenchment be challenged. Thirdly, the buyer would attempt to integrate the new employees into its business by compelling the employees of the old employer to accept its terms and conditions of service or face dismissal. See Jordaan *A Guide to South African Labour Law* (1992) 240–243.

27 GG 16259 of 1995-02-10.

28 Act 24 of 1936.

the original section 38 of the IA, upon provisional sequestration, stock used to be taken of assets and debts with the view of the fair distribution of what was left, while all contracts of employment came to an abrupt end by operation of law.<sup>29</sup> Viewed from a labour relations perspective, office equipment received more attention than employees who had rendered services for the former employer through thick-and-thin.

Apart from the fact that employees had always been entitled to limited preferences against the insolvent estate for arrear salaries at the time of insolvency,<sup>30</sup> the IA placed no responsibility on trustees or liquidators to treat employees fairly by following procedures similar to those prescribed in terms of labour legislation. In terms of insolvency law, contracts of employment terminated automatically by operation of law upon sequestration.<sup>31</sup>

## **4 2 After the 2002 Amendments**

Pressure exerted by organised labour on the insolvency fraternity, combined with the fundamental right to “fair labour practices” in terms of the Constitution,<sup>32</sup> resulted in a package of amendments to the LRA, the BCEA and the IA that came into effect at the end of 2002<sup>33</sup> and the beginning of 2003.<sup>34</sup> There can be no doubt that these changes enhanced employee protection in the situation where their employers became insolvent

Apart from removing the principle that contracts of employment are automatically terminated upon sequestration, a watered-down set of retrenchment procedures, akin to those contained in the LRA, were introduced into the IA to be followed by trustees and liquidators.<sup>35</sup> Since

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29 Whitear-Nel “The effect of insolvency on a contract of employment” 2000 21 *ILJ* 845.

30 S 98A of the IA.

31 Employees also had no right to severance pay. Prior to the 2002 amendments to the BCEA, s 41(2) of the BCEA only applied to the “dismissal” of employees based on operational requirements. See in this regard Lombard and Boraine “Insolvency and employees: An overview of statutory provisions” 1999 *De Jure* 300; Van Eck and Boraine “Voluntary winding-up of a company and ‘dismissals’ in terms of the Labour Relations Act” 2002 *THRHR* 610.

32 S 23(1) of the Constitution, 1996. See also Van Eck, Boraine and Steyn 2004 *SALJ* 902.

33 The amendments to the LRA and BCEA came into effect on 1 August 2002. See the Labour Relations Amendment Act 12 of 2002, *GG* 23540, and the Basic Conditions of Employment Amendment Act 11 of 2002, *GG* 23539, both published on 2002-06-24.

34 The amendments to the IA came into operation on 2003-01-01.

35 Viewed holistically, these labour-related provisions do not sit well within the IA that primarily regulates the equal treatment of creditors and the collective procedure for the fair distribution of the proceeds of insolvent estates. Why were these provisions included in the IA and not the LRA? The answer to this is that the IA guides trustees and liquidators once sequestration has entered the scene. In addition, trustees and liquidators have traditionally not been deemed to be employers because contracts of employment terminated automatically upon insolvency. Consequently, it is submitted that these provisions were quite correctly included in the legislative enactment crafted for the regulation for the activities of trustees and liquidators.

1 January 2003, section 38 of the IA provides for the initial suspension (and not the automatic termination) of contracts of employment between insolvent employers and their employees.<sup>36</sup> Subsequent to the suspension of the contracts, one of two things may happen: first, the trustee or liquidator may choose to refrain from taking any action in respect of the contracts of employment and the suspended contracts will come to an end by operation of law after the expiration of a window period of 45 days after the appointment of the final trustee;<sup>37</sup> secondly, the trustee or liquidator may take steps similar to those prescribed for an employer when retrenching employees if the decision is taken to terminate some or all of the contracts of employment.<sup>38</sup>

### 4 3 Sale of Business, Dismissal and Automatic Termination

It is worthy to note that the idea of business rescue was introduced into insolvency law with the 2002 amendments. Lawmakers recognised that it would be to the benefit of economic development and workers' interests to introduce a process which includes the imperative to explore the possibility of transferring the whole or part of the business in order to save as many contracts of employment as possible, rather than having them automatically terminated by operation of law. In light of the high unemployment rate experienced in South Africa, there is a sound economic rationale for the introduction of such a philosophy into insolvency law.

Section 38 of the IA provides that the final trustee or liquidator may terminate contracts of employment after a number of requirements have been met. In the first instance, the final trustee or liquidator must engage in consultations<sup>39</sup> with the same list of persons mentioned in the LRA when an operational requirements dismissal is contemplated.<sup>40</sup> Secondly,

36 Moalosi "The new law on suspended employee contracts: Termination of contracts of employment suspended by insolvency" 2003 11(2) *JBL* 64. After their suspension, employees are not obliged to work and they are not entitled to remuneration.

37 S 38(9) of the IA. This essentially takes us back to the position that prevailed prior to the 2002 amendments insofar as contracts terminated automatically. This still occurs, save for the fact that a window period has been introduced during which the contracts of employment are suspended.

38 *Idem* s 38(4).

39 The IA does not define the labour law induced phrase "to consult with employees". However, s 189 of the LRA describes consultations with the view of reaching consensus in the following broad scheme: the employer must give the other party the opportunity to make representations and to advance alternative proposals; the employer must consider and respond to such proposals; if the employer should disagree with the employees, he or she should state the reasons for such disagreement; and if the parties are unable to reach agreement, they should invoke any agreed procedure to resolve their differences before the employer's proposals may be introduced. It is submitted that although the IA is silent on the way in which consultations should take place, trustees and liquidators could safely rely on the above-mentioned procedures for purposes of their consultations with employees of the insolvent estate.

40 The list of institutions and people include any person required to be consulted in terms of a collective agreement, a workplace forum, a registered trade union whose members are likely to be affected or the employees themselves. See s 38(5) of the IA and s 189(1) of the LRA.

these consultations must be “aimed at reaching consensus on appropriate measures to save or rescue the whole or part of the business of the insolvent employer”.<sup>41</sup> Of importance is the fact that the IA directs that the discussions must be aimed at saving the whole or a portion of the business:

- “(a) by the sale of the whole or part of the business of the insolvent employer;
- (b) by a transfer as contemplated in section 197A of the Labour Relations Act, 1995;
- (c) by a scheme or compromise referred to in section 311 of the Companies Act, 1973; or
- (d) in any other manner.”

Thirdly, employees must have been given the opportunity to submit written proposals to the trustee or liquidator within 21 days of the appointment of the final trustee or final liquidator of a company.<sup>42</sup>

From the above, it is clear that during the consultations, the trustee or liquidator must, in the same breath, discuss the possibility of transfer of the business (or a part thereof) and the possibility of the dismissal of employees if no such transfer would occur. It is submitted that, in terms of the IA, nothing would preclude the trustee or liquidator from going ahead with the termination of some or all contracts of employment should negotiations with prospective buyers or employees fail to produce an agreement on such transfer. However, this could possibly be in conflict with the LRA’s protective measures prohibiting the dismissal of employees if such dismissal is deemed by the courts to “relate” to a transfer of a business as going concern.<sup>43</sup> The decision in the *Rand Airport Management* case may be interpreted as prohibiting all dismissals of employees whatsoever in these circumstances. Neither the IA nor the LRA makes provision for legal sanction against a liquidator or trustee should the responsible person fail to adhere to dismissal procedures during the process of sequestration. Nevertheless, employees could in all likelihood apply for an interdict to prevent the dismissal from occurring or, subsequent to their dismissal, they could even consider the possibility of instituting unfair dismissal proceedings resulting in a compensatory award (or even reinstatement) in terms of the LRA. This is something that trustees and liquidators will definitely take into account when considering the option of either actively terminating contracts or merely waiting for the expiration of the 45-day window period.<sup>44</sup>

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41 S 38(6) of the IA.

42 *Idem* s 38(7).

43 See the discussion of s 187(1)(g) of the LRA against the background of the *Rand Airport Management* case below.

44 An overriding factor that trustees and liquidators should remember is that both s 38 of the IA and ss 197 and 197A of the LRA provide that agreements can be reached with employees or their representatives regulating the situation during the sequestration process. It is advisable that specific agreements regulating the relevant circumstances should always be sought in an attempt to pre-empt the occurrence of employment-related problems at the end of the life cycle of any business. Such agreement will prevail over the protective provisions of both the IA and LRA.

## 5 Labour Law and Insolvency Law

### 5.1 Overlap between Insolvency and Labour Law

Prior to the 2002 amendments, problems arose between section 38 of the IA and section 197 of the LRA. Section 38 used to terminate contracts of employment automatically, whereas the LRA dictated that all contracts had to be transferred to the new employer should a transfer of the business take place after the sequestration or liquidation of the business. The inherent conflict lay in the fact that there were no contracts that could be transferred after sequestration or liquidation by virtue of the IA. However, paying heed to the LRA, which provides that the provisions of the LRA will prevail should they be in conflict with any other law (other than the Constitution),<sup>45</sup> the Commission for Conciliation, Mediation and Arbitration and courts held that the LRA prevails over the provisions of the IA.<sup>46</sup>

### 5.2 Section 197: General Provisions

The above-mentioned problems between the provisions of the IA and the LRA played a role when it was decided to amend the LRA and the BCEA during 2002. It was hoped that the changes would remove the inconsistencies between labour and insolvency legislation. However, when one takes a closer look at the prevailing provisions of sections 197 and 197A of the LRA and the present section 38 of the IA, it appears that the inherent conflicts do not only remain, but that they may have been exacerbated. This is especially so against the background of the general and wide-ranging statements made in the *Rand Airport Management* case that are discussed in more detail below. The LRA regulates the transfer of a business under both solvent<sup>47</sup> and insolvent circumstances.<sup>48</sup> Two requirements must be met before the protective measures will apply. First, it must be a “business” that is the subject of the transfer, and secondly it must be “transfer[red] as going concern”.<sup>49</sup> The definitions contained in the Act are not overly helpful in determining whether a business is in fact being transferred as a going concern,<sup>50</sup> but recent cases have started to flesh out the meaning of these central terms. A “business” is defined to “include the whole or part of any business, trade, undertaking or service”. It does not specify whether the practice of the outsourcing of non-core

45 S 210 of the LRA.

46 See *Hammond v L Suzman Distributors (Pty) Ltd* 1999 20 ILJ 3010 (CCMA); *Ndima & Others v Waverley Blankets Ltd* 1999 6 BLLR 577 (LC); *National Union of Leather Workers v Barnard and Perry NNO* 2001 4 SA 1261 (LAC).

47 S 197 of the LRA.

48 *Idem* s 197A.

49 *Idem* s 197(1).

50 Bosch “Of business parts and human stock: Some reflections on section 197(a) of the Labour Relations Act” 2004 25 ILJ 1865 1882 states that “the application of s 197 could give rise to many difficulties. There are many issues that have yet to confront the courts around what constitutes a ‘business’ for the purposes of s 197, and particularly around when an entity is part of a business, trade, undertaking or service”.

functions is covered. However, it is to be noted that the word “service” was included in the 2002 amendments to the LRA with the view of expanding this concept. “Transfer” 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”.

Under solvent circumstances, for the sake of brevity, the most significant consequences of the transfer of a business as going concern are as follows:<sup>51</sup> first, the new employer is automatically placed in the position of the old employer in respect of all contracts of employment; and secondly, anything done before the transfer by the old employer, including the unfair dismissal of the employee, is considered to have been done by the new employer.

The above provisions sought to address the lack of protection of employees under the common law. The new employer steps into the shoes of the old employer in respect of all contracts of employment without having to obtain agreement from the employees. Employees stay bound to their original contracts of service and are further protected insofar as they may bring the new employer to book for any unfair actions taken against them by the old employer.

### **5 3 Section 197A: Transfer under Insolvent Circumstances**

To what extent did the policy makers of labour legislation seek to create a culture of business rescue, as was the case in the IA, when the employer has passed the point of financial viability? Has the legislature included (or left out) anything in the LRA that would attract buyers into buying and rebuilding businesses that are on the verge of being dissolved? Section 197A(1) only applies in relation to the transfer of a business:

- “(a) if the old employer is *insolvent*; or
- (b) where a scheme of arrangement or compromise is entered into to avoid the winding-up or sequestration of the employer for reasons of insolvency.”

Once it is established that this section is applicable to a particular scenario, the most notable consequences will be, “[d]espite the Insolvency Act, 1936” and “unless otherwise agreed”, as follows:<sup>52</sup> Firstly, the new employer is automatically substituted in the place of the old employer in all contracts of employment in existence immediately before the old employer’s provisional winding-up or sequestration; and, secondly, anything done before the transfer by the old employer in respect of each employee is considered to have been done by the new employer.

From the above, it is obvious that the provisions of the LRA would prevail over the provisions of the IA. It is also clear that there is no reprieve for the new employer as regards giving him or her the opportunity of selecting only a preferred number of the employees in order to rebuild the insolvent business. All contracts must be transferred unless agreement to

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51 *Idem* s 197(6).

52 *Idem* s 197A(2).

the contrary can be reached.<sup>53</sup> Additional protective measures for employees have been included in the LRA that could, it is submitted, have a negative effect on the idea of business rescue as introduced by section 38 of the IA.

#### 5 4 Automatically Unfair Dismissals

The 2002 amendments introduced the principle that dismissal is automatically unfair if the “reason for dismissal is . . . a transfer, or a reason related to a transfer, contemplated in section 197 or 197A”.<sup>54</sup> This section makes it clear that should any employer terminate contracts of employment *because of*,<sup>55</sup> or for “a reason related to” the transfer of a business as going concern, such dismissal will be an automatic unfair dismissal attracting the maximum 24 months’ compensation.<sup>56</sup>

The LRA, unfortunately, does not make it clear that dismissal because of a transfer is proscribed, but that dismissal based on *bona fide* operational requirements, even in the context of a transfer of an undertaking, is permissible. As pointed out by Bosch:<sup>57</sup>

“It is interesting that previous drafts of the amendments gave employers express permission to dismiss based on their operational requirements in the transfer context. The fact that this is no longer made explicit should not be taken as a signal that it is not permissible . . . It would be bizarre to think that employers may not dismiss based on their genuine operational requirements.”

53 However, it is submitted that when facing the reality of sequestration or liquidation after the appointment of the trustee or liquidator, employees would be open to negotiate almost any deal, even on less favourable terms, as long as it would secure them a position with the new employer. In addition to this state of affairs, the new employer cannot be held liable for the unfair actions of the old employer that could possibly lead to action being taken before the labour dispute resolution institutions. However, this is where provisions in favour of new employers come to an end.

54 S 187(1)(g) of the LRA. It is not clear why it was deemed necessary to include this type of operational requirements dismissal to fall under the category “automatic unfair dismissal”, whereas, eg, operational requirement dismissals based on increasing profits are deemed to be permissible in law. As pointed out by Du Toit 2005 26 *ILJ* 595 606, there seems to be a contradiction in different Labour Appeal Court decisions between dismissal to make more profits and the traditional operational requirements dismissal based on economic survival. He states that there is an “apparent contradiction between the judgment in *Fry’s Metals [Fry’s Metals (Pty) Ltd v NUMSA* 2003 24 *ILJ* 133 (LAC)] and that in *Algorax [CWIU v Algorax (Pty) Ltd* 2003 24 *ILJ* 1917 (LAC)]. In *Fry’s Metals*, Zondo JP expressly rejected the contention that the ‘survival of the business or undertaking’ is the sole criterion for ‘fairness’ in relation to an operational decision to dismiss; in principle, an employer may also dismiss even if it ‘is making profit and wants to make more profit’. But if this is so, how can it also be said (to quote *Algorax*) that an employer may ‘only resort to dismissing employees for operational requirements as a measure of last resort’?”

55 Own emphasis.

56 See the discussion in Le Roux “Consequences arising out of the sale or transfer of a business” 2002 11(7) *CLL* 61 67.

57 Bosch 2003 24 *ILJ* 23 29.

This is indeed a regrettable situation, especially viewed against the background of the international position where it is made clear in foreign jurisdictions that a distinction should be drawn between dismissal because of a transfer and dismissal on grounds of genuine operational requirements within the context of a transfer. Whereas the former is outlawed, the latter is sanctioned.<sup>58</sup>

## 6 Returning to the *Rand Airport Management Case*

In the *Rand Airport Management* case, Davis AJA, on behalf of a unanimous Labour Appeal Court, firstly considered whether the outsourcing of the gardening services constituted the transfer of a “business”. The court held that because the word “service” had been included in the definition of “business”, it had been made clear that the outsourcing of gardening and security services does fall within the ambit of “business”.<sup>59</sup>

Secondly, Davis AJA traversed and confirmed previous case law that gave content to the term “transfer as going concern”. With reference to the Constitutional Court case *National Education Health and Allied Workers Union v University of Cape Town*<sup>60</sup> the court confirmed that the main test to determine a “business as going concern” is as follows: “What must be transferred is a business in operation ‘so that the business remains the same but in different hands’.”<sup>61</sup> To this, the court added that a number of factors could be relevant in deciding whether a business is being transferred as going concern:

“such as the transfer or otherwise of assets, both tangible or intangible, whether or not workers are taken over by the new employer, whether

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58 Smit investigated the legal situation regarding dismissal of employees surrounding transfers of business as going concerns in other countries. Having considered the European Acquired Rights Directive, Directive 77/187/EEC, the German *Bürgerliches Gesetzbuch* and the United Kingdom’s Transfer of Undertakings (Protection of Employment) Regulations (“TUPE”), she summarised the corresponding legal situation as follows: “Dismissal by either the transferor or the transferee are [sic] prohibited if the reason for the dismissal is the transfer of the undertaking or a part of the undertaking. However, this does not take away the employer’s right to dismiss employees for other reasons than the transfer of the undertaking. A dismissal for operational reasons . . . would therefore still be lawful . . . The motive for the termination is thus of crucial importance.” See Smit *Labour Law Implications of the Transfer of an Undertaking* (LLD thesis 2001 RAU) 69 and 72.

59 Pars 18–19. As an aside, it has subsequently been held by the Labour Court that second generation outsourcing is also covered by s 197 of the LRA. In the recently unreported case *COSAWU v Zikhethale Trade (Pty) Ltd* 2005 14 LC 11.3.2, it was held the second generation outsourcing, namely where a tender is awarded to a consecutive contractor, the principles of s 197 also apply. See also Bosch “Transfers of contracts of employment in the outsourcing context” 2001 22 *ILJ* 840; Schooling “Outsourcing the gardening: Outsourcing and the applicability of s 197 of the Labour Relations Act” 2002 *CLL* 112(3) 25; Le Roux “Outsourcing and the transfer of employees to another employer: What happens in the ‘second generation’ transfer?” 2005 *CLL* 14(12) 111.

60 2003 24 *ILJ* 95 (CC).

61 Par 56.

customers are transferred and whether or not the same business has been carried on by the new employer.”<sup>62</sup>

Having taken the above into consideration, Davis AJA held that, had the agreement with the third party to outsource the employees been implemented, this would have fallen within the protective measures of section 197.

Counsel for the Rand Airport Management Company argued that it was in any event entitled to retrench employees based on financial problems that the employer had experienced. To this it was added that the court should take the intention of the parties into account – was it the intention of the employer to dismiss employees on operational grounds or to transfer a business as going concern? In reply to this argument, Davis AJA held that the intention of the old and the new employer does not play a decisive role in determining whether section 197 applies.<sup>63</sup> To this he added:<sup>64</sup>

“The answer to Mr Pauw’s argument that the first respondent was entitled to dismiss the second and further appellants for operational requirements at the time that it did so is to be found in s 187(1)(g) of the Act . . . It provides that a dismissal is automatically unfair ‘if the reason for the dismissal is – a transfer, or a reason related to the transfer, contemplated in section 197 or 197A.’ Quite clearly the aim of this provision is to make it clear that the employer has no right to dismiss an employee because of a transfer contemplated in s 197 or 197A or for any reason connected with such a transfer.”<sup>65</sup>

Davis AJA took note of certain aspects of the international legal position in the transfer context, especially in relation to whether there had been a transfer of a business or service or not.<sup>66</sup> However, the prevailing international principle that holds that dismissal on grounds of genuine operational grounds is an excuse to unfair dismissal in the transfer context, was not mentioned at all. It is also to be noted that the court did not consider it necessary to implement the test of causality to determine, on a factual basis, whether the prospective dismissals would have occurred in response to operational requirements or the transfer of the business as going concern.

## 7 Final Comments

The LRA proscribes the termination of contracts of employment if the reason for the dismissal is “a transfer, or a reason related to a transfer, contemplated in section 197 or 197A”. However, elsewhere in the LRA,

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<sup>62</sup> *Ibid.*

<sup>63</sup> In a concurring but separate judgment, Zondo JP relied on the facts (and not merely the stated intention of the parties), as they were made clear in a letter from the employer to the employees, that the employer contemplated a transfer of a portion of the business as going concern and only if the employees did not find their new positions acceptable would they be retrenched in terms of the LRA.

<sup>64</sup> Par 32.

<sup>65</sup> Own emphasis.

<sup>66</sup> Par 26–29.

three grounds for dismissal are recognised, namely misconduct, incapacity and operational requirements.<sup>67</sup> It could be problematic to determine whether any particular dismissal is related to the *bona fide* operational requirements of the employer or whether it is based on the transfer of a business as going concern.

A similar situation presents itself in respect of the dismissal of striking employees. The LRA stipulates that the dismissal of employees participating in protected strike action constitutes an automatic unfair dismissal,<sup>68</sup> but provides for an exception to the rule, insofar as employers are permitted to dismiss striking employees should it be based on the operational requirements of the employer.<sup>69</sup> In this context, the question could arise whether any particular dismissal of striking employees is based on the fact that they are participating in a strike, or whether it is based on the operational requirements of the employer. As suggested by Smit,<sup>70</sup> the two-stage causality test, as applied in *SA Chemical Workers Union v Afrox Ltd*<sup>71</sup> (in the context of the dismissal of striking employees), can be used to determine whether any particular dismissal is because of a transfer or whether it is based on the employer's operational requirements. This test can be translated to the transfer situation as follows: in stage one, factual causality is established. Would the dismissal have occurred in any event, even if there had been no transfer of the business as going concern? If the answer is positive, factual causation is not established to the transfer and the dismissal would not be automatically unfair. However, if the answer is negative, then one proceeds to stage two, namely legal causation. Is such transfer the "main or dominant", or 'proximate' or 'most likely' cause of the dismissal?"<sup>72</sup> If it was, the dismissal will fall under automatically unfair dismissals.

It is submitted that it would have been a logical development had Davis AJA applied the causation test to the facts of the *Rand Airport* decision and to transfer decisions in general. However, in my view, the court may deliberately have decided to steer away from applying the test in the first instance, because it may have culminated in a different result. Counsel for the Rand Management Company may well have succeeded during the first stage of the enquiry, namely that the employer would have dismissed the employees even if it had not been for the agreement to transfer, thus swaying the scale in favour of employers in the transfer situation.

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67 S 188 of the LRA.

68 S 67(4) provides: "An employer may not dismiss an employee for participating in a protected strike or for any conduct in contemplation or in furtherance of a protected strike." S 187(1)(a) further places the dismissal of employees participating in protected strike action in the category "automatically unfair dismissals".

69 S 67(5) provides: "Subsection (4) does not preclude an employer from fairly dismissing an employee in accordance with the provisions of Chapter VIII for . . . a reason based on the employer's operational requirements".

70 Smit 307.

71 1999 20 *ILJ* 1718 (LAC).

72 Par 32.

Viewed from an insolvency law perspective, section 38(6) of the IA directs in no uncertain terms that trustees and liquidators must discuss with employees the possibility of transferring the business or a portion thereof as a going concern during the process of operational requirements dismissals. Although the IA does not state so explicitly, section 38(6) may even be open for the interpretation that trustees and liquidators are entitled to retrench some employees to make the sale of the business an attractive proposition for prospective buyers. For what other reason would this point have been included in the IA under the topics for discussion during operational requirements dismissals? As mentioned above, this encourages the idea of business rescue. The line of argument could be as follows: the old employer was unable to make a success of the business prior to insolvency. The trustee or liquidator is unable to secure potential buyers with existing limited business potential, taking account of the number of existing contracts of employment. All contracts of employment will terminate automatically after a window period should the *status quo* remain. It would be beneficial to employees' interests to terminate some contracts of employment to make the sale of the business as going concern an attractive proposition for prospective buyers. The new employer could possibly rebuild the business and offer employment to the dismissed employees at a later stage.

However, it is submitted that there is a real danger that trustees and liquidators will not follow the above line of argument for two main reasons. Firstly, the *Rand Airport Management* decision – even though the facts did not relate to an insolvent employer – appears to be narrow in its interpretation of section 187(1)(g), to such an extent that it doesn't leave room for the dismissal of employees in the transfer situation even though there may be *bona fide* reasons for dismissal based on operational requirements. Secondly, this decision, combined with the words “despite the Insolvency Act” as contained in section 197A of the LRA, may very well encourage trustees and liquidators to avoid the risks involved in the termination of contracts of employment altogether and rather to wait for the automatic termination of contracts of employment by operation of law after expiry of the window period.

Although this argument has not yet been tested before the courts, it is submitted that, should a trustee or liquidator be faced with a situation whereby the sale of a business is challenged after the retrenchment of employees with the view of making it attractive for resale, their only fragile defence could lie in the following as yet untested argument: In *NEHAWU v University of Cape Town*<sup>73</sup> the Constitutional Court held that a business is transferred as a going concern if what is being transferred is a business “in operation” but in different hands. It could be argued by

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<sup>73</sup> Par 56. Support for this argument may be found in Wests's *Legal Thesaurus and Dictionary* where “going concern” is defined as “an existing solvent business operating in its ordinary and regular manner”. See *National Education Health & Allied Workers Union v University of Cape Town* 2002 23 ILJ 306 (LAC) par 10 where reference was made to this definition.

trustees or liquidators that the business has ceased to operate upon sequestration or liquidation of the business of the employer and that what is being terminated is not a business as a “going concern”.

It is submitted that it would have been a positive development, to “advance” one of the LRA’s central goals, namely “economic development”,<sup>74</sup> had the legislature left scope for the dismissal of some employees of an insolvent business to give it an opportunity to grow more jobs after a business rescue by a new employer. This would at least save it from the fate of the piecemeal sale of assets and the ultimate termination of all contracts of employment after the trustee or liquidator has entered the scene.

It is clear that it was the initial intention of the legislature to protect employees during the transfer situation. However, it seems that there is a real possibility that this granting of protection may lead to employees being prejudiced. It would indeed be a sorry day if employers experiencing severe financial problems expelled any thoughts about transferring some or all employees during a restructuring exercise, for fear of it being classified as an automatic unfair dismissal should the initial attempts to transfer the business be unsuccessful. This may lead to employers rather following the safe route, by merely dismissing employees on operational grounds right from the beginning as sanctioned by the LRA.

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74 S 1 of the LRA.