

FAIR LABOUR PRACTICES IN SOUTH AFRICAN INSOLVENCY LAW

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INTRODUCTION

The South African Constitution provides that ‘everyone has the right to fair labour practices’.¹ The term ‘fair labour practice’ is not defined in the Constitution, yet this fundamental right encompasses far more than is expressed in the narrow definition of the term in the Labour Relations Act 66 of 1995 (LRA).² While labour lawyers may instinctively grasp the concept of the right to fair labour practices without necessarily being provided with a comprehensive description of the right, insolvency practitioners may wonder what precisely this broad right entails, particularly in the context of an employer’s insolvency.³

Insolvency lawyers are also likely to be curious as to how the right to fair labour practices achieved its prominent status, enshrined as it is in the statute that embodies the supreme law of the land. They may even experience a certain measure of apprehension by virtue of the fact that the drafters of the Constitution thought fit to entrench this central labour right which, in effect, encourages the placement of employees in a separate category of creditors of their employer’s insolvent estate. The right to fair labour practices may potentially conflict with, or restrict, other fundamental rights that underpin the insolvency regime such as, for example, the right of creditors to be treated equally, as reflected in the *pari passu* principle, and also the property-based

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¹ Section 23 of the Constitution of the Republic of South Africa, Act 108 of 1996.

² *National Education Health and Allied Workers Union v University of Cape Town* (2003) 24 ILJ 95 (CC) para 30; *National Entitled Workers Union v CCMA* (2003) 24 ILJ 2335 (LC) at 2339. See also, regarding the early development of the term ‘unfair labour practice’, Martin Brassey, Edwin Cameron, Halton Cheadle & Marius Olivier *The New Labour Law* (1987) chap 1 and T Poolman *Equity, the Court and Labour Relations* (1988) 1.

³ It is to be noted that this article is based on an unpublished paper delivered at the Insol International Academics meeting in Cape Town, held in April 2004, which was a follow-up on André Borainé & Stefan van Eck ‘The new insolvency and labour legislative package: How successful was the integration?’ (2003) 24 ILJ 1840.

rights of secured creditors. Section 36(2) of the Constitution states that only laws conforming to the test for valid limitations in s 36(1)⁴ can legitimately restrict rights. However, it also provides that rights can be justifiably limited in terms of 'any other provision of the Constitution'. Courts will endeavour to construe apparently conflicting provisions in such a way as to harmonize them with one another.⁵ Thus, from an insolvency lawyer's perspective, understanding the basis for the recognition of the right to fair labour practices in the South African Constitution, and the nature and extent of the concept of a fair labour practice, is an important prerequisite for establishing its impact upon insolvency law and practice.

THE RIGHT TO FAIR LABOUR PRACTICES: HISTORICAL BACKGROUND

In 1979, fourteen years before the advent of the new constitutional democracy in South Africa, the government, led by the old National Party, took a tentative step towards deracializing the workplace by extending the same labour rights to both black and white workers and trade unions.⁶ At the same time as the repeal of the statutory regulation of job reservation for white workers,⁷ a new Industrial Court was instituted. This was an administrative tribunal with broad jurisdiction to make determinations regarding 'unfair labour practices'. In essence, the Industrial Court was given carte blanche to act as watchdog and to develop and define the concept as it deemed fit.⁸ The definition was 'open textured to the extreme',⁹ and was initially defined as 'any practice which in the opinion of the Industrial Court constitutes an unfair labour practice'.¹⁰ Thus, between 1980 and 1995, by means of numerous so-called value judgements, the Industrial Court and the Labour

⁴ In terms of s 36(1), the limitation must be reasonable and justifiable in an open and democratic society based on dignity, equality and freedom, taking into account all relevant factors, including the nature of the right, the importance of the purpose of the limitation, the nature and extent of the limitation, the relationship between the limitation and its purpose and less restrictive means to achieve this purpose.

⁵ Johan de Waal, Iain Currie & Gerhard Lubbe *The Bill of Rights Handbook* 4 ed (2001) 163.

⁶ The Industrial Conciliation Act 11 of 1924, forerunner of the current legislation that regulates labour relations, explicitly excluded pass-bearing African workers from the definition of 'employee', with the consequence that they could not join registered trade unions. Equal labour rights were granted to workers of all race groups in a series of amendments over a period of four years. The amendments were contained in the Industrial Conciliation Amendment Acts 94 of 1979 and 95 of 1980 and the Labour Relations Amendment Acts 57 of 1981, 51 of 1982 and 2 of 1983. See Darcy du Toit et al *Labour Relations Law* (2000) 8–13 for an overview of the reform of the labour law system from 'exclusion to inclusion'.

⁷ The Industrial Conciliation Amendment Act 94 of 1979 repealed s 77 of the Industrial Conciliation Act 28 of 1956, which regulated job reservation primarily in favour of job security for white workers.

⁸ P A K le Roux & André van Niekerk *The South African Law of Unfair Dismissal* (1994) 19.

⁹ Etienne Mureinik 'Unfair labour practices: Update' (1980) 1 *ILJ* 113.

¹⁰ This definition was replaced and amended during 1980 and 1982, respectively, but it was only marginally more specific. In terms of the Labour Relations Amendment Act 51 of 1982, an unfair labour practice was defined as any act or omission, other than a strike or lock-out, which has or may have the effect that:

- (a) any employee or class of employees is or may be unfairly affected or that his or their employment opportunities or work security is or may be prejudiced or jeopardised thereby;
- (b) the business of any employer or class of employers is or may be unfairly affected or disrupted thereby;
- (c) labour unrest is or may be created or promoted thereby; or
- (d) the labour relationship between employer and employee is or may be detrimentally affected thereby.

Appeal Court ‘fashioned an extensive, although sometimes uneven’¹¹ new body of South African labour law.¹²

Early in its development, it was recognized that South African employment law was based primarily on common-law principles of contract¹³ which are largely blind to the unequal status and bargaining power of employers and their employees.¹⁴ It also became apparent that contractual principles were insufficiently developed to regulate the intricate relationships inherent in the modern workplace. Thus a new balance developed between the disparate status and bargaining power of employers and employees, inter alia through the decisions of the old Industrial Court and the enactment of new labour legislation. This, in turn, saw the gradual erosion of common-law principles in favour of the employee, who was seen as the weaker party.¹⁵ Under its unfair labour practice jurisdiction, a totally new jurisprudence developed containing guidelines regarding, for example, the right not to be unfairly dismissed on grounds of misconduct, fair procedures to be followed for retrenchment of employees, and the obligation of employers to engage in good faith in collective bargaining with trade unions and principles relating to strikes and lock-outs.

The Black trade union movement played a prominent role in events leading up to the demise of the apartheid regime and the holding of the first democratic elections on 27 April 1994.¹⁶ Their influence is reflected in the comprehensive set of labour rights which was included in the Constitution, under the heading ‘labour relations’, which incorporates the ‘umbrella’ right to ‘fair labour practices’. In *National Education Health and Allied Workers Union v University of Cape Town* the Constitutional Court held as follows:

‘Our Constitution is unique in constitutionalizing the right to fair labour practice. But the concept is not defined in the Constitution. The concept of fair labour practice is incapable of precise definition. This problem is compounded by the tension between the interests of the workers and the interests of the employers that is inherent in labour relations. Indeed, what is fair depends upon the circumstances of a particular case and essentially involves a value judgment. It is therefore neither necessary nor desirable to define this concept.’¹⁷

¹¹ Du Toit et al op cit note 6 at 11.

¹² See *MWASA v The Press Corporation of SA Ltd* (1992) 13 ILJ 1391 (A) at 1400C–E, where the Appellate Division held that when the definition of unfair labour practice is considered, it is not a question of law or a question of fact that has to be answered, but it is the ‘passing of a moral judgment’ based on law and fairness. This administrative tribunal drew mainly upon guidelines provided by the International Labour Organization and foreign case law in constructing and developing an unfair labour practice jurisprudence to provide guidance as to do’s and don’ts in the workplace.

¹³ In terms of common-law principles, a contract of employment could legitimately be terminated merely by adhering to the notice period that had been agreed upon contractually, notwithstanding the reason or motive for termination. See J Neethling & P A K le Roux ‘Positiefregtelike erkenning van die reg op die verdienvermoë of “the right to exercise a chosen calling”’ (1987) 8 ILJ 719 at 720.

¹⁴ Ibid. Brassey et al op cit note 2 at 6 has ascribed this unequal relationship to the simple reason that most employees need a job and wages more than an employer needs the services of an employee. However, sometimes the employee may be in a strong individual bargaining position vis-à-vis the employer. Such a person is described by Otto Kahn-Freund *Labour and the Law* 3 ed (1983) 17 to include ‘a high powered managerial employee with unique experience, a top rank scientist, or even a highly skilled craftsman’.

¹⁵ John Grogan *Workplace Law* 7 ed (2003) 27.

¹⁶ The trade union movement, with the Congress of South African Trade Unions (COSATU) at the forefront, played an important role in the struggle against apartheid, becoming involved in numerous political stay-aways, school boycotts and political marches. The ANC, COSATU and the South African Communist Party formed a three-party alliance that played a major role in the negotiation of a new constitution for South Africa. See Du Toit et al op cit note 6 at 17.

¹⁷ Supra note 2 para 33. See also *MWASA v The Press Corporation of SA Ltd* supra note 12 at 1400C–E.

In *National Entitled Workers' Union v CCMA*,¹⁸ in the Labour Court, Landman J explained the concept thus:

'The concept of a fair labour practice ... recognizes the rightful place of equity and fairness in the workplace. In particular the concept recognizes that what is lawful may be unfair. T Poolman neatly summarizes the strength and nature of the concept. He says in *Principles of Unfair Labour Practice* (Juta) at 11:

"The concept 'unfair labour practice' is an expression of the consciousness of modern society of the value for the rights, welfare, security and dignity of the individual and groups of individuals in labour practices. The protection envisaged by the legislature in prohibiting unfair labour practices underpins the reality that human conduct cannot be legislated for in precise terms. The law cannot anticipate the boundaries of fairness or unfairness of labour practices. The complex nature of labour practices does not allow for such rigid regulation of what is fair or unfair in any particular circumstance.

Labour practices draw their strength from the inherent flexibility of the concept 'fair'. This flexibility provides a means of giving effect to the demands of modern industrial society for the development of an equitable, systematized body of labour law. The flexibility of 'fairness' will amplify existing labour law in satisfying the needs for which the law itself is too rigid."

Thus the right to fair labour practices derives its content from, inter alia, labour legislation and the decisions of the Constitutional Court and specialist fora, such as the Commission for Conciliation, Mediation and Arbitration (CCMA) and the labour courts.

Soon after the promulgation of the Constitution and the first democratic elections in 1994, the new LRA of 1995 was enacted. It codified, to a certain extent, the decisions of the abolished Industrial Court and erased the catch-all unfair labour practice jurisdiction contained in the old LRA.¹⁹ The right to fair labour practices was given expression in a number of provisions of the LRA (and other labour legislation), such as an employee's right not to be unfairly dismissed, the protection of employees when a business is transferred as a going concern, and the right to severance pay.²⁰ Today, a floor of rights has been created in labour legislation for the employee, who is generally seen as the weaker party in the employment relationship.²¹ These basic rights arise from the inclusion of provisions which limit the employer's unfettered discretion as to whom it elects to appoint to a position,²² the setting of minimum conditions of employment²³ and the prescription of protective requirements which must be met when an employer contemplates dismissing any employee,²⁴ or when it contemplates the transfer of a business as a going

¹⁸ Supra note 2 at 2339.

¹⁹ See Stefanus R van Jaarsveld & Stefan van Eck *Principles of Labour Law* (2002) 2 ed at 175–80.

²⁰ See chap VIII of the LRA, which regulates 'Unfair dismissal and unfair labour practice'.

²¹ See in this regard Nicola Smit *Labour Law Implications on the Transfer of an Undertaking* unpublished LLD thesis, Rand Afrikaans University (2001) 7.

²² Section 6(1) of the Employment Equity Act 55 of 1998 prohibits unfair discrimination in any 'employment policy or practice', which in turn includes the recruitment, selection and appointment of employees.

²³ The BCEA prescribes, inter alia, minimum and maximum conditions of employment in relation to hours of work, different types of leave and notice of termination of service.

²⁴ Employees are, inter alia, protected against unfair dismissal on grounds of misconduct, incapacity, incompetence and operational requirements. See ss 185–197 of the LRA. See also the 'Code of good practice: Dismissal' and the 'Code of Good Practice on Dismissal Based on Operational Requirements' published in terms of s 203 of the LRA.

concern, whether under solvent or insolvent circumstances. This floor of rights also impacts upon other fields of law, such as insolvency law, in which the rights of employees are involved. The LRA of 1995 provides a definition of 'unfair labour practice' which is far more limited not only than the concept which the old Industrial Court was required to interpret, but also the concept of fair labour practices to which each person has the right in terms of the Constitution.²⁵ In essence, after most of the principles that had been laid down by the old Industrial Court had been codified in the Act, a limited number of aspects which were not covered elsewhere were combined in the definition of unfair labour practice. Currently the definition of unfair labour practice in the LRA regulates mostly disputes that arise during the course of the employment relationship, concerning promotion, demotion, training, suspension, probation and the provision of benefits.²⁶

LABOUR-DRIVEN INSOLVENCY LAW REFORM

Since the 1980s an urgent need has often been expressed for the reform of the law of insolvency, and the South African Law Commission has been involved in an ongoing review of this branch of the law. Yet, ironically, the labour movement, and not the needs of insolvency practice, was the engine which drove the insolvency law reform processes that have taken place so far.

At the insistence of the trade union movement,²⁷ major reforms to insolvency and labour law were instituted in 2002 and 2003 with the introduction of a 'package' of amendments to the Insolvency Act 24 of 1936 (IA), the LRA and the Basic Conditions of Employment Act 75 of 1997 (BCEA). It is our submission that all of these reforms can be traced back to the fundamental right to fair labour practices: certainly, the IA had never before undergone such extensive amendment in the 65 years since its enactment. From a labour perspective, these reforms have not gone far enough in that they did not introduce a proper business rescue regime into South African insolvency law. However, it is submitted that the momentum behind the initiatives for the urgent introduction of business rescue provisions in South African insolvency legislation, currently an issue of high priority at government level, has similarly been fuelled by the labour movement. Thus, the

²⁵ See *National Entitled Workers Union* supra note 2 at 2338I, where it was held that the definition of unfair labour practice contained in the LRA is limited to such an extent that it does 'not contemplate a labour practice committed by an employee vis-à-vis an employer'. However, at 2340G the court further alluded to the fact that the 'LRA is not intended to regulate the entire concept of fair labour practice as contemplated in the Constitution 1993 nor the present Constitution. The field is far too wide to be contemplated by a single statute.'

²⁶ Section 186(2). Van Jaarsveld & Van Eck op cit note 19 at 179–86; Grogan op cit note 15 at 228–44.

²⁷ Adam Harris 'The Impact of South African labour law on insolvency practice in South Africa', paper delivered at the International Bar Association Conference 20–25 October 2002. On 2 August 1999 COSATU gave notice to NEDLAC that it intended to commence with protest action inter alia on the ground that 'insolvency laws must be amended to alleviate the adverse effects of liquidations upon workers and their financial security'. This notice was submitted to NEDLAC on 2 August 1999 in terms of s 77(1)(b) of the LRA.

foundations for such an intervention have been laid and the labour fraternity eagerly anticipates the further developments in this area.²⁸

In what follows, we aim to focus upon the more significant labour rights (all of which fit neatly under the umbrella right to fair labour practices) which have relevance when an employer becomes insolvent, and to highlight some of the difficulties occasioned by conflicts or tensions between the different philosophies underlying insolvency and labour law respectively. Drafters of legislation (who may specialize in only a particular branch of the law) are often not equipped to reconcile these inherent differences in philosophy. For example, whereas labour law seeks to protect the interests of employees by promoting job security and continuity of employment, insolvency law focuses on aspects such as the closing down of a business, its liquidation and the equitable distribution of liquidated assets amongst creditors. The juncture at which insolvency and labour law meet is an area of legal regulation where the tension between commercial interests, on one hand, and the general right of employees to social protection, on the other, is arguably at its greatest.²⁹

THE CONTINUITY OF CONTRACTS OF EMPLOYMENT UPON SEQUESTRATION OR LIQUIDATION

Under the broad right to fair labour practices, every employee has the right not to have his or her contract of employment unfairly terminated.³⁰ As a starting point, s 185 of the LRA provides that ‘every employee has the right not to be unfairly dismissed’. This right is given content by s 188(1), which provides two prerequisites for any fair dismissal: there must be a *fair reason* for dismissal (also referred to as substantive fairness) which must be effected in accordance with a *fair procedure* (procedural fairness). Substantive fairness basically requires that there be a good enough reason for termination of the contract of employment.³¹ The LRA recognizes financial hardship as a fair reason for dismissal based on the employer’s operational requirements.³² Procedural fairness is founded on the broad principles of *audi alteram partem* as found in administrative law.³³ Section 189 of the LRA lays down the correct procedures to be followed for retrenchments under solvent circumstances. These procedures are dealt with in more detail below.

²⁸ It is to be noted that the Master’s Business Unit has appointed task teams to look into the development of a new business rescue regime, but that nothing has yet been published officially.

²⁹ *Schutte v Powerplus Performance (Pty) Ltd and Super Group Trading (Pty) Ltd* [1999] 2 BLLR 169 (LC) para 30; B Jordaan ‘Transfer, closure and insolvency of undertakings’ (1991) 12 *ILJ* 935.

³⁰ See Edwin Cameron ‘The right to a hearing before dismissal’ Part 1 (1986) 7 *ILJ* 183–217 and Part 2 (1988) 9 *ILJ* 147–86 for a discussion of the development of the right not to be unfairly dismissed under the unfair labour practice jurisdiction of the old Industrial Court. See also P A K le Roux & André van Niekerk *The South African Law of Unfair Dismissal* (1994) 1–8.

³¹ John Grogan *Dismissal* (2002) 55 (hereafter *Grogan Dismissal*) states ‘it can be accepted that the reason for dismissal relates to the ground or grounds that prompted the employer to terminate the contract. The ground for dismissal, and its adequacy, must be established by objective enquiry.’

³² Section 213 of the LRA defines ‘operational requirements’ to include the ‘economic, structural or similar needs of the employer’. See also Du Toit et al op cit note 6 at 380; *Hammond v L Suzman Distributors (Pty) Ltd* (1999) 20 *ILJ* 3010 (CCMA) at 3019A.

³³ *Modise v Steve’s Spar Blackheath* (2000) 21 *ILJ* 519 (LAC) para 15. The right to fair administrative action, in relation to employees of the state, is also protected by s 33 of the Constitution and the Promotion of Administrative Justice Act 3 of 2000.

Although the LRA contains no provisions in relation to termination of contracts of employment in the context of insolvency, it would be anathema to modern labour law for contracts of employment to terminate automatically upon the occurrence of a particular event. However, at common law it is recognized that an individual contract of employment is automatically terminated upon supervening impossibility of performance.³⁴ Notably, this is only the case where impossibility of performance is absolute (or objective) as opposed to relative (or subjective), and where such impossibility is not attributable to any fault on the part of the debtor.

Before 1 January 2003, the effect of s 38 of the IA was that all contracts of employment between an insolvent employer and its employees automatically terminated on the date of sequestration or liquidation, subject to the right of the employees to claim damages, available at common law, for losses sustained as a result of such termination.³⁵ Section 38 was never challenged on the grounds of common-law principles, that is, on the ground that the insolvency of the employer (and the subsequent sequestration or liquidation) did not necessarily constitute supervening impossibility of performance (in that insolvency might have been attributable to fault on the part of the employer or that there existed merely relative or subjective inability on the part of the employer to fulfil its obligations). However, s 38 was challenged against the background of the right to fair labour practices. After the implementation of the LRA of 1995, various difficulties were encountered in the interpretation of s 38,³⁶ particularly in relation to whether automatic termination of an employment contract in terms of the section constituted a 'dismissal' for the purposes of the LRA³⁷ and in relation to the status of employment contracts when an insolvent business was transferred as a going concern in terms of s 197 of the LRA.³⁸

In *National Union of Leather Workers v Barnard and Perry NNO*³⁹ the Labour Appeal Court held that the passing of a special resolution for a creditors' voluntary winding-up of a company unable to pay its debts amounted to a 'dismissal' as envisaged by s 186 of the LRA. The court drew a distinction between a voluntary winding-up and a compulsory winding-up by the court on the basis that in the latter, the decision to wind up rests ultimately with the court and not with the shareholders. It is respectfully submitted that this reasoning is incorrect. It was the inability of the company to pay its debts that

³⁴ Martin Brassey 'The effect of supervening impossibility of performance on a contract of employment' 1990 *Acta Juridica* 22; Van Jaarsveld & Van Eck op cit note 19 at 133.

³⁵ Section 100 of the IA (now repealed) used to provide, and now s 98A of the IA provides, for limited preferent claims for employees. See the discussion below.

³⁶ See E C Schlemmer & A N Oelofse 'Konflik tussen die wet op arbeidsverhoudinge en die insolvensiewet' (1996) 3 *TSAR* 559; Sulette Lombard & André Boraine 'Insolvency and employees: An overview of statutory provisions' 1999 *De Jure* 300. Cf J A Kunst et al *Meskin: Insolvency law and its Operation in Winding-up* (2003 update) para 5.21.10.1.

³⁷ See, for example, *National Union of Leather Workers v Barnard and Perry NNO* (2001) 4 SA 1261 (LAC) and the discussion of this case in B P S van Eck & A Boraine 'Voluntary winding-up of a company and dismissal in terms of the Labour Relations Act' (2002) 65 *THRHR* 610.

³⁸ See *Ndima v Waverley Blankets Ltd* (1999) 6 *BLLR* 577 (LC).

rendered applicable the provisions of s 38 of the IA read with s 339 of the Companies Act 61 of 1973, and not the process by which the winding-up occurred. In effect, by deeming the affected employees to have been 'dismissed', the court afforded them additional preferent claims to which they would not otherwise have been entitled. It may be noted that, in light of the most recent set of amendments to the IA, the LRA and the BCEA, it has become irrelevant whether the winding-up was voluntary or compulsory as employees are now entitled, in either event, to a preferential claim for severance pay, as discussed below. Nevertheless, the *Leather Workers* case illustrates how not only the legislature, but also the judiciary, has taken cognizance of the influence of labour law.

Yet another illustration of insolvency law reform brought about by the implementation of the umbrella right to fair labour practices is the new provision which replaced s 38 of the IA. In 2003 this section was amended to provide that the 'contracts of employment of employees whose employer has been sequestrated are suspended with effect from the date of the granting of a sequestration order'.⁴⁰ Thus the position of employees has been ameliorated in that termination of their employment contracts is no longer a *fait accompli* upon sequestration or liquidation of their employer. Instead the contracts are merely suspended, although they nevertheless remain valid and binding. Ironically, it is submitted, a fair amount of support for this development may be found in the common law, in that, strictly speaking, the sequestration or liquidation of an employer does not necessarily result in contracts of employment being terminated on account of supervening impossibility. Furthermore, the old s 38, which provided for the termination of all contracts of employment upon the insolvency of the employer, did not cater for the possibility of a trustee or liquidator selling a business as a going concern, which would result in some, if not all, of the employment contracts being transferred with it.

Notably, contracts of employment are not suspended indefinitely: after the initial suspension (which occurs upon sequestration or liquidation) the trustee or liquidator may terminate some or all of the contracts,⁴¹ or they automatically terminate by operation of law⁴² when the time-limits have expired. Thus, in terms of the new s 38, any dismissals of employees whose contracts of employment are suspended may only take place after the final trustee or liquidator has followed a prescribed procedure as spelt out in the IA. On the other hand, should the final trustee or liquidator decide not to initiate the process for the termination of any employment contract, it will automatically terminate 45 days after the appointment of the *final* trustee or liquidator, or in the case of a close corporation, 45 days after the appointment of a co-liquidator in terms of s 74 of the Close Corporations Act 69 of 1984,

³⁹ (2001) 4 SA 1261 (LAC).

⁴⁰ Section 38(1).

⁴¹ Section 38(4).

⁴² Section 38(9).

unless a contrary agreement has been reached. Such automatic termination could take place at any time between two and six months after the date of sequestration or liquidation.⁴³

It is often stated that the trustee or liquidator steps into the shoes of the insolvent party to an unexecuted contract in order that he or she may deal with the contract since the trustee or liquidator assumes the rights and obligations of the insolvent party to the contract.⁴⁴ While, in this context, the trustee or liquidator assumes the position of ‘employer’, clearly he or she has also acquired new, statutorily prescribed functions in relation to employment contracts. Of course, the trustee or liquidator may employ new persons in the insolvent enterprise, or arrange for existing employees to assist in the interim period. However, in any such arrangements it should be clear how and when they will terminate, since the principles of labour law will be applicable to them.

It is evident that, should a trustee or liquidator wish to terminate any employee’s services on grounds, for example, of misconduct during the period of suspension, the procedures prescribed in the LRA must be followed. However, should a trustee or liquidator wish to terminate any employee’s contract of employment to make the business more attractive in order to be able to sell it as a going concern, the procedures to be followed are those laid down in the IA, and not the LRA. This, it is submitted, is something of a misalignment in the respective labour and insolvency legislative frameworks.⁴⁵ Traditionally, the LRA was the statute that prescribed procedures to be followed for the termination of employment contracts. Now, procedures along the lines of those prescribed in s 189 of the LRA, which must be followed for the termination of employment contracts on grounds of operational requirements, under solvent circumstances, have been introduced into the IA for the first time. This, in our submission, is yet another clear illustration of how an employee’s right to fair labour practices has extended its influence into the field of insolvency law.

Unless an agreement has been reached (with a view to saving or rescuing the business in terms of s 38(6)) for continued employment, all contracts of service not already terminated will terminate 45 days after the appointment of the final trustee or liquidator. Thus, clearly, the new legislative provision merely postpones the automatic termination of the contract. Trustees and liquidators who are unwilling to take risks in relation to the dismissal of employees will in all probability, we submit, simply allow the 45-day period to lapse, after which the employment contracts will terminate automatically.

⁴³ The (final) trustee or liquidator can only be appointed after the first meeting of creditors that is convened after sequestration or winding-up — see in general Kunst *op cit* note 36 para 4.2 and 4.22. In practice the appointment usually occurs between five and eight weeks after sequestration or winding-up — but may take longer.

⁴⁴ See Kunst *op cit* note 36 para 5.21.

⁴⁵ See Boraïne & Van Eck *op cit* note 3 at 1840ff.

It is also interesting to note that s 38(8) provides that a creditor (who is not an employee) may only participate in the s 38 consultations with the consent of the trustee. While it is not clear what type of participation is envisaged, presumably such a creditor may also make proposals regarding the future of the business. The important difference is that while employees or their representatives have a clear right to be consulted in this regard, other creditors cannot insist upon it.

THE RIGHT TO BE CONSULTED PRIOR TO TERMINATION OF THE CONTRACT OF EMPLOYMENT

Sections 189 and 189A of the LRA apply to the situation where an employer wishes to retrench employees prior to sequestration or liquidation based on grounds of prevailing economic circumstances. Prior to the most recent set of legislative amendments, the same rules applied to all retrenchments. However, since 2002 a distinction has been drawn between small-scale and large-scale retrenchments: additional requirements have been imposed for larger employers who contemplate retrenchment of large numbers of employees.⁴⁶ A consideration of the requirements for retrenchments by small employers will, in our view, provide some indication of the reasons or basis for the retrenchment procedures that have been prescribed in the IA.

The LRA's retrenchment provisions are aimed at minimizing retrenchments in circumstances where an employer can no longer afford to retain the services of all of the employees. While it is not the intention of the legislature to force employers to retain redundant employees, the process is aimed at limiting (or, if possible, avoiding) retrenchments.⁴⁷ Employers are also entitled to retrench employees in an attempt to increase profits, although it has been held that more stringent standards will be imposed, requiring them to offer alternative employment, to provide training and to give more generous severance benefits.⁴⁸

As with other forms of dismissal, the LRA requires that there be a fair reason for, and a fair procedure leading up to, any retrenchment.⁴⁹ The courts have previously indicated that it is not their purpose to second-guess the business decisions of the employer, although they would pass judgment on whether it was merely a sham or whether the reason for dismissal was

⁴⁶ Section 189A prescribes additional procedures for employers having 50 or more workers and who are involved in large-scale retrenchment. These procedures apply only if a large employer contemplates dismissing, respectively, 10 employees, if that employer employs up to 200 employees; 20 employees, if that employer employs more than 200 employees; 30 employees, if that employer employs 300 employees; and so forth. Provision is also made for the appointment of a neutral facilitator in order to assist with the consultation process (as described above) prior to retrenchment, and for the matter to be referred to the Labour Court to determine if the retrenchment is operationally justifiable. Further, employees are entitled to strike in order to dissuade the employer from retrenching employees. See P A K le Roux 'The new law on retrenchment' (2002) 11 *Contemporary Labour Law* 101–8 for a discussion of s 189A.

⁴⁷ Grogan op cit note 15 at 197.

⁴⁸ *Seven Abel CC t/a The Crest Hotel v HRWU* (1990) 11 ILJ 504 (LAC); *NCBAWU v Natural Stone Processors (Pty) Ltd* (2000) 21 ILJ 1405 (LC).

⁴⁹ Van Jaarsveld & Van Eck op cit note 19 at 224.

genuine.⁵⁰ More recently, however, the courts have signalled a greater preparedness to inquire whether the employer had a bona fide reason for terminating the contract of employment in that ‘the content of the reasons given by the employer’⁵¹ will also be considered.

As far as the procedure is concerned, *consultation* with representatives of the employees, or the employees themselves, forms the crux of the process.⁵² The parties required to be consulted are any person whom the employer is required to consult with in terms of a collective agreement; or, if there is no collective agreement which requires consultation, a workplace forum (if one exists) and any registered trade union whose members are likely to be affected by the proposed dismissals; or, if there is no workplace forum, any registered trade union whose members are likely to be affected by the proposed dismissals; or, if there is no registered trade union, the employees (or their representatives) whose contracts are likely to be affected.⁵³ The LRA prescribes that as soon as an employer ‘contemplates dismissing one or more employees’ on the ground of operational requirements, the employer must consult with a view to reaching consensus on various issues, including measures to avoid or minimize dismissals, ways to mitigate the adverse effects of the dismissals, the method of selecting the dismissed employees, and severance pay for dismissed employees.⁵⁴

The LRA also imposes an obligation on employers to disclose in writing to the other consulting party all relevant information, including, but not limited to, the reason for dismissal, the number of employees likely to be affected, the proposed selection criteria, the proposed severance pay and the possibility of future re-employment of the employees who are to be dismissed.⁵⁵ In *Johnson & Johnson Ltd v CIWU*⁵⁶ the Labour Appeal Court aptly stated that the formal obligations of s 189 are ‘geared to ... achieve a joint consensus-seeking process’ on issues mentioned in the section. It was held that a mechanical check-list approach is inappropriate, and that instead, the approach to be adopted should be to ascertain whether the purpose of the section has been achieved. Consultation, in the context of the LRA, means more than merely taking counsel and hearing representations from the other party before making a

⁵⁰ *Kotze v Rebel Discount Liquor (Pty) Ltd* (2000) 11J 129 (LAC) 133. See also *SACTWU v Discreto — A Division of Trump & Springbok Holdings* (1998) 19 11J 1451 (LAC).

⁵¹ In *BMD Knitting Mills (Pty) Ltd v SACTWU* (2001) 11J 2264 (LAC) 2269 it was held that the starting point of the enquiry is whether there is ‘commercial rationale’ for the decision. The court further held that it ‘is entitled to examine the content of the reasons given by the employer’.

⁵² The Code of Good Practice on Dismissal Based on Operational Requirements, promulgated in GG 20254 of 16 July 1999, provides guidelines with regard to the procedures to be followed during a dismissal on grounds of operational requirements.

⁵³ Section 189(1) of the LRA.

⁵⁴ Section 189(1) of the LRA. In Item 3 of the Code of Good Practice on Dismissal based on Operational Requirements it is stated that the ‘purpose of consultation is to enable the parties, in the form of a joint problem-solving exercise, to strive for consensus if that is possible’. See also *NUMSA v Atlantis Diesel Engines (Pty) Ltd* (1993) 14 11J 642 (LAC), where it was held that the duty to consult arises as soon as the employer senses that it might have to retrench employees to meet operational objectives.

⁵⁵ Section 189(3) of the LRA.

⁵⁶ (1998) 19 11J 89 (LAC) para 27.

decision. The goal is to hold bona fide discussions aimed at reaching a compromise agreement.

Returning to the IA and the retrenchment procedures it prescribes, it may be noted that the same consultative philosophy apparent in the LRA has been incorporated in the IA. While the final trustee or liquidator has the right to terminate the contracts of service of some or all of the employees, this may only take place after requirements, similar to those prescribed in the LRA, have been followed. The first requirement is that the final trustee or liquidator must enter into consultations with the same parties as specified in the LRA.⁵⁷ The second formal requirement in terms of the IA⁵⁸ is that 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:

- (a) by the sale of the whole or part of the business of the insolvent employer; or
- (b) by a transfer as contemplated in section 197A of the Labour Relations Act, 1995; or
- (c) by a scheme or compromise referred to in section 311 of the Companies Act, 1973; or
- (d) in any other manner.⁵⁹

If any of the consulting parties wishes to make proposals concerning any of the issues mentioned above, such party must submit written proposals to the trustee or liquidator within 21 days of the appointment of the final trustee;⁵⁹ the appointment of a final liquidator for a company;⁶⁰ the appointment of a co-liquidator for a close corporation;⁶¹ or the date of the conclusion of the first meeting, if a co-liquidator is not appointed for a close corporation.⁶²

Neither the IA nor any provision in the LRA spells out what the effect will be of a final trustee or liquidator terminating contracts of employment without conducting proper consultations, in terms of s 38 of the IA, with the required persons on the prescribed topics. However, it is submitted that such an employee may apply for an interdict, in either the High Court or the Labour Court, to halt the process of termination of the employment contract and to order such consultations.⁶³ Our further submission is that, should the trustee or liquidator fail to follow the procedures prescribed in the IA and aimed at protecting employees against unfair dismissal, the matter may be referred for adjudication to the Labour Court on grounds of unfair dismissal on operational grounds as contemplated by the LRA.⁶⁴ Potentially, this would entitle an employee to the statutory remedies available in terms of the LRA, namely reinstatement or compensation of up to 12 months' remuneration.⁶⁵

⁵⁷ Section 38(5) of the IA.

⁵⁸ Section 38(6).

⁵⁹ The final trustee is appointed in terms of s 56 of the IA.

⁶⁰ Section 375 of the Companies Act 61 of 1973.

⁶¹ Section 74 of the Close Corporations Act 69 of 1984.

⁶² Section 38(8) of the IA.

⁶³ Section 157(2) of the LRA provides that the Labour Court has concurrent jurisdiction with the High Court in respect of any violation of any fundamental right entrenched in the Constitution arising from the application of any law for the administration of which the Minister of Labour is responsible.

⁶⁴ Section 188 and s 191(5)(b)(ii) of the LRA. It is further submitted that the CCMA lacks the jurisdiction to hear a dismissal on grounds of operational requirements in the case of non-compliance with s 38 of the IA. Section 191(12) of the LRA restricts the CCMA's jurisdiction to the dismissal of single employees who were dismissed by reason of the employer's operational requirements following a consultation procedure in terms of s 189 of the LRA.

⁶⁵ Section 193 and s 194 of the LRA.

However, in view of the fact that the employee's contract has already been suspended and that the employee is not entitled to remuneration after sequestration or liquidation, our submission is that reinstatement of the already suspended contract of employment would be the only appropriate remedy in the circumstances.⁶⁶

It should be noted that, unlike in the LRA,⁶⁷ no duty is imposed in the IA upon the trustee or liquidator to disclose to the employees relevant information such as the exact financial position of the employer or the number of employees likely to be retrenched. Interesting, also, is that in terms of the LRA, consultations are aimed at discussing measures to avoid or minimize the number of dismissals to be effected by a particular employer, whereas in terms of the IA, consultations are aimed at business rescue and the transfer of the business to a new employer.

Thus, in our view, by giving the employees the right to be consulted, the legislature has accorded them a new status as a special interest group, or even a special class of creditor, within the broader insolvency regime. Apart from the fact that they may attend the various creditors' meetings in their capacity as creditors, they also obtain the right to assist in the formulation of a decision to sell the insolvent's business as a going concern. Although it is questionable whether this accords with the rest of the process of the administration of insolvent estates,⁶⁸ it is submitted that this does signify a step in the right direction in so far as it focuses on the rescue of whole, or parts of, businesses. While in the past s 38 provided for the automatic termination of contracts of employment upon the sequestration of the employer, the legislature has now, for the first time, highlighted workers' rights as an important consideration within the insolvency regime. Employees are now empowered to make suggestions either in connection with the sale of viable sections of the business or for the purchase of the business as a going concern to be made more attractive to potential buyers of the insolvent business. This heralds a new approach to business rescue in South Africa, which, we submit, should be welcomed.

THE RIGHT TO SEVERANCE PAY

Prior to the amendments to the BCEA on 1 August 2002, s 41 provided that an employer must pay to an employee 'who is dismissed' for reasons based on the employer's operational requirements, severance pay equal to at least one week's remuneration for each completed year of continuous service with that

⁶⁶ In the context of the power to terminate the contracts of employment discussed above, it is our opinion that a trustee may not exercise the right to terminate these contracts unless the period of 21 days, calculated from the date of his or her final appointment, has expired. The IA clearly provides that the trustee or liquidator must consult with the parties listed in s 38(5) and that he or she must wait for proposals, if any, in terms of s 38(7) before the contracts of employment may be terminated.

⁶⁷ Section 189(4)(a) read with s 16 of the LRA.

⁶⁸ For instance, the continuation of the insolvent's business has been viewed as an exception rather than the rule in the past, and the Master may authorize the sale of movable or immovable property of the insolvent before the second meeting of creditors — see ss 80 and 80bis of the IA and see further Van Eck & Boraine *op cit* note 3 at 1861.

employer. This gave rise to the question whether employees who had accrued years of service with a particular employer were entitled to severance pay upon the automatic termination of their employment contracts (in terms of the old s 38 of the IA) when the estate of their employer was sequestered or liquidated.

*Hammond v L Suzman Distributors (Pty) Ltd*⁶⁹ demonstrates the role the constitutional right to fair labour practices has played in insolvency law reform.⁷⁰ In this case the employer applied for voluntary liquidation. The employees, some of whom had served their employer for 40 years, received only one week's notice pay upon liquidation of the company. When the employees applied to the CCMA for severance packages, it was argued on behalf of the employer that the employees had not been dismissed in terms of s 41 of the BCEA, but that their contracts of employment had automatically terminated in terms of s 38 of the IA. Despite an earlier Labour Court decision, *SA Agricultural Plantation & Allied Workers Union v HL Hall & Sons (Group Services) Ltd*,⁷¹ which held that the reach of labour law halts when insolvency law enters the picture, the commissioner determined that s 38 of the IA constituted a prima facie violation of the fundamental right to fair labour practices as set out in s 23(1) of the Constitution.⁷² The CCMA accepted the argument that in the case of a voluntary liquidation the directors of the company pass a resolution authorizing the application, and that they effectively initiate and pilot the process and in effect dismiss the employees.⁷³ The employees' right to severance pay under these circumstances was accordingly confirmed.

It should be noted that this is no longer an issue in light of the amendment, with effect from 1 August 2002, of s 41 of the BCEA, which now reads as follows:

'An employer must pay an employee who is dismissed for reasons based on the employer's operational requirements or whose contract of employment terminates or is terminated in terms of section 38 of the Insolvency Act, 1936 (Act No. 24 of 1936), severance pay equal to at least one week's remuneration for each completed year of continuous service with that employer, calculated in accordance with Section 35' (our emphasis).

Further, in terms of s 98A of the IA, which also came into effect with the package of amendments on 1 August 2002,⁷⁴ severance pay has become an additional category of preferent claim for an employee whose employer becomes insolvent.

⁶⁹ (1999) 20 ILJ 3010 (CCMA). This is another example of how the thinking of the CCMA and the courts has been influenced by the introduction of the right to fair labour practices into the Constitution.

⁷⁰ For a discussion of this case see Nicci Whitear-Nel 'The effect of insolvency on a contract of employment' (2000) 21 ILJ 845 at 846.

⁷¹ (1999) 20 ILJ 399 (LC).

⁷² See also *Waverley Blankets Ltd v CCMA* (2000) 21 ILJ 2738 (LC) para 27, where the constitutionality of s 38 of the IA was also questioned.

⁷³ See *National Union of Leather Workers* supra note 37 and the criticism of this case in Van Eck & Boraine op cit note 37.

⁷⁴ See the discussion below.

Trustees and liquidators need to know how severance pay is calculated. First, as far as the definition of 'remuneration' is concerned, it should be noted that s 35(5) of the BCEA provides that the Minister of Labour, after hearing submissions from interested parties, may determine what is to be included in the definition of 'remuneration'. An extensive definition of 'remuneration' has since been published which includes the following payments made by an employer to the employee: a housing or accommodation allowance or subsidy; a car allowance or the provision of a car; and employer's contributions to medical aid, pension, provident fund or similar schemes.⁷⁵ Secondly, as mentioned above, employees are only entitled to severance pay in relation to every completed year of continuous service. Thus, if, for example, an employee was appointed nine months before the employer's sequestration or liquidation, the employee is not entitled to severance pay at all. However, should an employee resign from an employer, but at a later stage again take up employment with the same employer, and the break in between the periods of employment was less than a year, the period of employment preceding the interruption will be taken into account for the purposes of calculating the employee's entitlement to severance pay.⁷⁶ Thirdly, the method of calculation applies to all employees, irrespective of whether it is in relation to managerial or other employees.⁷⁷

SOCIAL SECURITY ISSUES IN INSOLVENCY

Under the new dispensation the financial position of employees, upon the sequestration or liquidation of their employer's estate, has been improved. Thus the vulnerability of this group of creditors has been recognized and, to some extent, addressed. The new s 38(3) provides that, during the period of suspension of the employment contract, an employee is not required to render services, nor is the employer obliged to pay the employee remuneration. In addition, no employment benefit arising out of the suspended contract accrues to the employee. Further, during the period of suspension of the employment contract, the employee is deemed, in terms of the Unemployment Insurance Act 63 of 2001,⁷⁸ to be unemployed for the purposes of the Act and is thus entitled to unemployment insurance benefits.⁷⁹ In addition, the status of employees' preferent claims for arrear salaries, for other employment benefits (such as accrued leave pay) and for severance pay has also been improved, as discussed below.

In terms of the IA, the proceeds of property subject to securities must be applied first to the payment of the cost of maintaining, conserving and

⁷⁵ See GG 24889 of 23 May 2003 for the definition of 'remuneration'.

⁷⁶ Section 84(1) of the BCEA. See also *Insurance & Banking Staff Association obo Aucamp v Old Mutual Life Insurance Co* (2000) 21 ILJ 2515 (CCMA).

⁷⁷ *Imperial Cold Storage & Supply Co Ltd v Field* (1993) 14 ILJ 1221 (LAC).

⁷⁸ Act 63 of 2001. Section 83(3) of the IA still refers to the old Unemployment Insurance Act 30 of 1966.

⁷⁹ See M P Olivier et al *Introduction to Social Security* (2004) 311 for a discussion of the calculation of unemployment benefits in terms of this act.

realizing that property.⁸⁰ If such proceeds are insufficient to cover these costs, the amount of the deficit must be paid into the estate, by way of a contribution, by those creditors who have proved claims and who rely on the particular security for payment of their debt.⁸¹ The free residue, being that portion of the estate which is not subject to any security,⁸² as well as any balance remaining after settling a secured claim out of the proceeds of the sale of the particular asset which secured the payment of the debt, is applied to the payment of the remaining (unsecured) creditors in the prescribed order of preference.

Unsecured creditors may be divided into two classes, namely statutory preferent creditors and concurrent creditors. Sections 96 to 102 of the IA provide for the payment of statutory preferent claims in a prescribed order of preference. Employees' claims are statutory preferent claims in terms of s 100 (which was applicable before 1 September 2000) and s 98A (which has been applicable since 1 September 2000) of the IA. Consequently, the payment of these claims is dependent upon sufficient funds being available in the free residue. The effect of the deletion of s 100 and the insertion of s 98A in its place (effective since 1 September 2000) was to elevate the position of the preferent claim of an employee, in the hierarchy of statutory preferent creditors, and also to increase the maximum amounts applicable to employees' preferent claims.⁸³

In terms of s 98A(1)(a) of the IA, an employee of the insolvent is entitled to a (statutory) preference (payable out of the free residue) for:

- (i) any salary or wages, for a period not exceeding three months, due to an employee (the amount of this preference is limited to R12 000 per employee);
- (ii) any payment in respect of any period of leave or holiday due to the employee which has accrued as a result of his or her employment by the insolvent in the year of insolvency, or the previous year, whether or not payment thereof is due at the date of sequestration (the amount of this preference is limited to R4 000 per employee);
- (iii) any payment due in respect of any other form of paid absence for a period not exceeding three months prior to the date of sequestration of the estate (the amount of this preference is limited to R4 000 per employee); and
- (iv) any severance or retrenchment pay due to the employee in terms of any law, agreement, contract or wage-regulating measure, or as a result of termination in terms of s 38 (the amount of this preference is limited to R12 000 per employee).⁸⁴

⁸⁰ Section 89(1) of the IA.

⁸¹ See s 106 of the IA.

⁸² See definition of 'free residue' in s 2 of the IA.

⁸³ Section 98A was inserted into the IA by the Judicial Matters Second Amendment Act 122 of 1998, which came into operation on 1 September 2000.

⁸⁴ It should be noted that this part of the section was amended by the Insolvency Amendment Act 33 of 2002 in order to make provision for a preference for severance pay.

The maximum amounts permissible for these preferences may be adjusted and will be determined from time to time by the Minister of Justice by notice in the *Government Gazette*. Such adjustments will be subject to a process of consultation as provided for in s 98A(2).

The object of this amendment was to bring South African insolvency law into line with the International Labour Organization's Convention on the Protection of Workers' Claims (Employer Insolvency) 173 of 1992.⁸⁵ The response of the Congress of South African Trade Unions (COSATU) to the amendment⁸⁶ has been that while it constitutes an improvement, it does not go far enough to address the union's earlier demands for the radical reform of insolvency laws, including, in particular, that employees' claims should rank above those of secured creditors. It may also be noted that, while s 98A(6)(b) envisages the creation of schemes or funds which would guarantee to employees the protection which is afforded to them by s 98A, no such schemes or funds exist as yet. The creation of a super-priority, ranking above the claims of secured creditors, and the creation of guarantee funds for employees' claims raise, in our submission, distributional questions of fairness as well as constitutional issues which deserve consideration.

It may be argued that the granting of a super-priority to employees' claims, which would rank above the claims of secured creditors, would infringe or impair the property rights, protected by s 25 of the Constitution, of secured creditors. Another important concern is that super-priorities may affect credit availability by imposing higher risks for secured creditors and for potential lenders.⁸⁷ Ironically, this has the potential to jeopardize prospects of investment in a business, and consequently, in certain circumstances, will undermine the feasibility of the rescue of an ailing business. We submit that the provisions of any such super-priority need to be very carefully considered lest it be regarded as an arbitrary deprivation of property rights of secured creditors on the basis that insufficient reason exists for it, or that there is no appropriate relationship between the sacrifice which the secured creditors are asked to make and the public purpose which the deprivation is intended to serve.⁸⁸

In relation to the creation of a special fund to guarantee prompt payment of employees' claims, an important consideration is who would bear the cost of this. If the cost is too high for the government (making use of public funds), or

⁸⁵ As stated in the memorandum on the objects of the Judicial Matters Amendment Bill 1997 [B95-97], available at <http://www.gov.za/gazette/bills/1997/b95-97.pdf> [21 October 2004].

⁸⁶ See COSATU's submissions on the Insolvency Regulations presented to the Department of Justice and Constitutional Affairs in terms of s 98A(2), available at <http://www.cosatu.org.za/docs/2000/insolreg.htm> [21 October 2004].

⁸⁷ See, for example, similar submissions in relation to proposals for wage-earner protection provisions to be included in Canadian legislation in the Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, available at http://strategies.ic.gc.ca/epic/internet/incilp-pdci.nsf/en/h_l_c100674e.html [21 October 2004]. See also Bill C-474, introduced into the House of Commons of Canada on 9 February 2004, available at http://www.parl.gc.ca/37/3/parbus/chambus/house/bills/private/C-474/C-474_1/C-474_cover-E.html [21 October 2004].

⁸⁸ See *First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 (4) SA 768 (CC) paras 98-100.

for employers or employees (through contributions), or for other preferent or concurrent creditors (who, as a result, would receive a lower dividend or none at all), this could undermine the constitutionality of such a statutorily created fund. If a special guarantee fund operates to the detriment of other creditors, it may be argued that there is no rational basis, as required by s 9 of the Constitution, for the differential treatment of employees and of other creditors to escape a challenge brought on the basis of the right to equality. It may also, in appropriate circumstances, be argued that there is no justification, as required by s 36(1) of the Constitution, for employees to receive treatment which is so markedly different from that received by other creditors of the insolvent estate. While we acknowledge that such funds exist in some jurisdictions,⁸⁹ we submit that the feasibility of the creation and administration of such a fund should be assessed on the basis of economic realities in South Africa.

Thus these legislative reforms, affecting the ranking and maximum amounts of preferent claims in insolvency, inspired and driven as they were by labour imperatives, have significantly improved the social security position of employees of an insolvent. However, we question whether the improvements are more apparent than real. Our concern is that, where the free residue is insufficient to cover the costs of sequestration, all creditors who have proved claims against the estate are required to contribute towards these costs. Concurrent (non-preferent) creditors contribute in proportion to their claims, and secured creditors contribute in relation to the portion of their claims paid out of the free residue.⁹⁰ An employee is not exempt from the application of this provision in the IA and may thus also become liable to make a contribution, especially if he or she proves a claim in respect of the non-preferential portion of it. Further, bearing in mind the alterations proposed by COSATU to the limitations imposed on the maximum claims permissible in terms of s 98A, with a view to ensuring greater protection for low-income earners,⁹¹ our submission is that empirical studies should be conducted in order to ascertain the extent of the real benefit to employees under the current system of preferences as compared with the previous dispensation.

THE RIGHT TO HAVE ONE'S EMPLOYMENT CONTRACT TRANSFERRED WITH A BUSINESS SOLD AS A GOING CONCERN

In terms of common-law principles, the sale of a business does not, in the absence of a specific agreement to that effect, impose a duty on the purchaser to enter into contracts of employment with the employees of the seller.⁹²

⁸⁹ For example, Australia, England and Wales, and Ireland.

⁹⁰ Section 106 of the IA.

⁹¹ See the case studies annexed to COSATU's submissions at <http://www.cosatu.org.za/docs/2000/insolreg.htm> [21 October 2001].

⁹² Alan Rycroft & Barney Jordaan *A Guide to South African Labour Law* (1992) 240.

Thus, at common law, where a business was sold, the seller could simply terminate the contracts of employment and, further, it would be up to the purchaser to decide whom to employ in his or her newly acquired business. However, labour legislation provides that when a business is transferred as a going concern, all contracts of employment are transferred from the old employer to the new employer.⁹³ Thus the enactment of these protective measures signalled a complete departure from the common-law position, recognizing the social impact that a sale of a business may have on the lives of employees by placing a duty on purchasers of businesses to take over all employees of the old employer.⁹⁴ Notably, although this principle was only introduced into South African labour law during 1996,⁹⁵ in Europe the position has been regulated for more than 20 years.⁹⁶

On the other hand, in terms of (the old) s 38 of the IA, the insolvency of an employer simply put an end to employment contracts, irrespective of whether the business was transferred to a buyer in the course of a sequestration or liquidation process. Thus it would seem that a conflict existed between the insolvency law and labour law principles in that, when a business was sold under insolvent circumstances, there would be no employment contracts to transfer to the purchaser of the business. Initially, this raised the question whether labour law prevailed over insolvency law or vice versa,⁹⁷ an issue that has largely been resolved by the package of amendments effected in 2002 and 2003. The introduction of the new principle in South African insolvency law that, upon the sequestration or liquidation of an employer, employment contracts are merely suspended, rather than automatically terminated, may be ascribed to the influence on insolvency law of the LRA and the recognition of the fundamental right to fair labour practices. Further, this influence has indirectly introduced a business rescue culture into insolvency law.

Section 197A(1) applies to the transfer of a business if the old employer is 'insolvent' or where a 'scheme of arrangement or compromise is entered into to avoid the winding-up or sequestration of the employer for reasons of insolvency'.⁹⁸ Although it is not always an easy task to determine whether a business is being 'transferred as a going concern',⁹⁹ the consequences of the

⁹³ Sections 197 and 197A of the LRA.

⁹⁴ Rycroft & Jordaan op cit note 92 at 242.

⁹⁵ The old s 197 came into operation with the promulgation of the LRA on 11 November 1996.

⁹⁶ See Smit op cit note 21 at 52–76 for a discussion of the development of the regulation of the transfer of businesses as going concerns, at international level. Also see the following leading European cases regarding this concept: *Spijkers v Gebroeders Benedik Abbatoir* [1986] 2 CMLR 486; *Schmidt v Spar- und Leihkasse der Früheren Amter Bordschholm Kiel und Cronshagen* [1994] IRLR 302; *Suzen v Zehnacker Gebäudereinigung GmbH Krankenhausservice* [1997] IRLR 255.

⁹⁷ *Waverley Blankets Ltd v CCMA* (2000) 21 ILJ 2738 (LC) para 9; *Ndima v Waverley Blankets Ltd* supra note 38 paras 2–16; Frances G Anderson 'Unravelling the proposed amendments to the Insolvency Act' (2001) 22 ILJ 868 at 870; and Boraine & Van Eck op cit note 3.

⁹⁸ Section 197A(1)(b) of the LRA. Such a scheme of arrangement or compromise may be entered into under common law or, in the case of a company, in accordance with the provisions of s 311 read with s 312 of the Companies Act and in the case of a close corporation in liquidation, under the provisions of s 72 of the Close Corporations Act.

⁹⁹ See the following cases dealing with the question whether in fact a business is being transferred as a going concern: *Schutte v Powerplus Performance (Pty) Ltd* (1999) 20 ILJ 655 (LC); *Foodgrow, a Division of*

section will be that '[d]espite the Insolvency Act, 1936', and 'unless otherwise agreed in terms of s 197(6)',¹⁰⁰

- (a) 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;
- (b) all the rights and obligations between the old employer and each employee at the time of the transfer remain rights and obligations between the old employer and each employee;
- (c) anything done before the transfer by the old employer in respect of each employee is considered to have been done by the old employer; and
- (d) the transfer does not interrupt the employee's continuity of employment and the employee's contract of employment continues with the new employer as if with the old employer.'

The words 'despite the Insolvency Act' make it clear that the LRA is intended to 'trump' the IA.¹⁰¹ This, in our submission, is untenable. In effect this means that, notwithstanding the fact that s 38(9) of the IA provides that 'all suspended contracts of employment shall terminate 45 days' after the appointment of the final trustee or liquidator, if an insolvent business is transferred as a going concern only after termination of employment contracts by the trustee or liquidator, or only after expiry of the 45 days, all terminated contracts will have to be revived and will be transferred to the new employer in terms of s 197A. Hence, what becomes apparent is that the conflict which existed between (the old) s 38 of the IA and (the old) s 197 of the LRA may have survived the amendments. It may well be that the only effect of the legislative changes has been to postpone the issues surrounding the termination of the employment contracts, unless of course the trustee or liquidator has secured a transfer of the business as a going concern to a new employer prior to expiry of the 45-day period.

The rights of employees have been bolstered further by a new provision, s 187(1)(g) of the LRA, which provides that a dismissal is 'automatically unfair' if the 'reason for dismissal is . . . a transfer, or a reason related to a transfer, contemplated in s 197 or 197A'.¹⁰² To place it in context, the other categories of automatically unfair dismissals listed in s 187 relate, *inter alia*, to the dismissal of employees on grounds of their pregnancy¹⁰³ and unfair discrimination against employees.¹⁰⁴ To a certain extent these may all be viewed as the most unacceptable kinds of dismissals¹⁰⁵ which could not, in any

Leisurenet Ltd v Keil (1999) 20 ILJ 2521 (LAC); *National Education Health & Allied Workers Union v University of Cape Town* (2000) 21 ILJ 1618 (LC); *National Education Health & Allied Workers Union v University of Cape Town* (2002) 23 ILJ 306 (LAC); *National Education Health & Allied Workers Union v University of Cape Town* (2003) 24 ILJ 95 (CC).

¹⁰⁰ Section 197A(2) of the LRA; our emphasis.

¹⁰¹ See also the discussion in *Boraine & Van Eck* *op cit* note 3.

¹⁰² See also the new s 186(1)(f) of the LRA and the discussion thereof in P A K le Roux 'Consequences arising out of the sale or transfer of a business: Implications of the Labour Relations Amendment Act' (2002) 11 *Contemporary Labour Law* 61 at 67.

¹⁰³ Section 187(1)(e).

¹⁰⁴ Section 187(1)(f).

¹⁰⁵ While compensation is limited to 12 months' remuneration for other unfair dismissals, s 194(4) entitles an employee to a maximum compensatory award of 24 months' remuneration in respect of dismissals that fall within this category of unfair dismissals.

circumstances, be considered to be fair. Once it is proved that an employee is dismissed for any reason specified in s 187, the employer will have no defence¹⁰⁶ and the dismissal will be regarded as 'unfair'.

Thus s 187(g) proscribes the dismissal of employees by the old or the new employer before or after a transfer of a business, upon the grounds of such transfer. The question may be raised whether this precludes the old or the new employer from dismissing employees, before or after a transfer, upon any other grounds, such as genuine operational requirements. Section 197 does not distinguish between dismissal on the grounds of the transfer of a business and on the grounds of genuine operational requirements of the employer.¹⁰⁷ Although our courts have not yet had the opportunity to consider this issue, it is submitted that such a distinction ought to be drawn and that such dismissals on the grounds of operational requirements,¹⁰⁸ before or after the transfer, should be permitted, as they are in other jurisdictions.¹⁰⁹ This would have the effect that dismissals on the grounds of operational requirements would be dealt with under ss 189 and 189A and that dismissals based on the transfer of the business itself would be dealt with under s 187(g) of the LRA.

Although modern insolvency law is moving towards a business rescue philosophy,¹¹⁰ developments in South Africa are clearly still lagging behind current international trends towards adopting and embracing a rescue culture.¹¹¹ While, via the IA, a tentative step in the right direction has been taken through the imposition of an obligation on trustees and liquidators to consider the rescue of a business before employment contracts are terminated, even the LRA does not clearly promote the notion of business rescue with a view to the turnaround of insolvent businesses and the preservation of

¹⁰⁶ Grogan op cit note 15 at 130.

¹⁰⁷ Craig Bosch 'Operational requirements dismissals and section 197 of the Labour Relations Act: Problems and possibilities' (2002) 23 *ILJ* 641 at 645 states that a 'previous draft of the proposed amendments, while making it automatically unfair to dismiss on account of transfer covered by s 197, went on to provide that old employers might dismiss an employee in accordance with the provisions of chapter 8 of the LRA based on its operational requirements or those of the new employer, and the new employer might dismiss employees based on its operational requirements'.

¹⁰⁸ Bosch op cit note 107 at 657 argues that employers should surely be permitted to dismiss on their genuine operational requirements in the process of restructuring in which s 197 transfers take place. Le Roux op cit note 102 at 68 seems clear on the point that the new employer could take the bona fide decision to retrench in order to cut costs after a transfer and that it will not fall foul of s 187(g). However, Grogan op cit note 14 at 143 does not seem to draw the distinction between transfer-related dismissals and retrenchment on bona fide grounds. He states that the legislature has not indicated how long the employees will be protected against the retrenchment by the purchaser after the transfer of a business.

¹⁰⁹ Smit op cit note 21 at 294; Bosch op cit note 107 at 648. In the United Kingdom reg 8(1) of the Transfer of Undertakings (Protection of Employment) Regulations 1981, SI 1981/1794 provides that where any employee is dismissed, either before or after a transfer, and the transfer or a reason connected to it is the principal reason for the employee's dismissal, the employee must be treated as unfairly dismissed. However, the same regulations recognize that if economic or organizational reasons of either the old or new employer is the reason for dismissing the employee, such employee will not be deemed to have been unfairly dismissed and will be subjected to the ordinary laws of unfair dismissal.

¹¹⁰ See Axel Flessner 'Philosophies of business bankruptcy law: An international overview' in Jacob S Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 19. See also Department of Trade *Insolvency Law and Practice, Report of the Review Committee* (chaired by Sir Kenneth Cork (HMSO Cmnd 8558) 1982 para 198.

¹¹¹ See P Kloppers 'Judicial management — A corporate rescue mechanism in need of reform?' (1999) *Stellenbosch LR* 417; P Kloppers 'Judicial management reform — Steps to initiate a business rescue' (2001) 13 *SA Mercantile LJ* 359. See also *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* 2001 (2) SA 727 (C).

employment for all or at least some of the employees after sequestration or liquidation of their employer.

It is submitted that the legislature might have come closer to striking an appropriate balance between the interests of employers and employees had it drawn a clear distinction, especially in circumstances of insolvency, between the dismissal of employees based solely on the grounds of the transfer of a business as a going concern and dismissal based on operational requirements, during the transfer. Our concern is that the lack of such a distinction may reduce the potential for the sale of businesses as going concerns and may well adversely affect the willingness of trustees, liquidators and prospective purchasers of such businesses to investigate the potential for business rescue.¹¹² The risk inherent in the purchase, as a going concern, of an insolvent business is increased in that the courts may classify dismissals which take place after the transfer as automatically unfair. Notwithstanding these concerns, however, it is hoped that the current focus on the interplay between labour law and insolvency law will serve as the catalyst for the promotion, development and adoption of a comprehensive business rescue system in our legal framework.

THE RIGHT TO BE NOTIFIED OF THE PENDING SEQUESTRATION OR LIQUIDATION

Trade unions insisted that they should receive timeous notification when businesses are experiencing financial difficulties which may result in sequestration or liquidation. The response to this demand is reflected in the latest package of legislative amendments that have effectively created a right to information for employees.¹¹³

An insolvent debtor, as defined in s 2 of the IA, may, by way of notice of motion, apply to the relevant court for the acceptance of the surrender of his or her estate for the benefit of his or her creditors.¹¹⁴ Before bringing such application the debtor must publish a notice of surrender in the *Government Gazette* and in a newspaper circulating in the district where he or she resides or, if the debtor is a trader, the district in which his or her principal place of business is situated. Within seven days of the publication of such notice, the debtor must deliver or post a copy of such notice to every one of his creditors whose address he knows or can ascertain.¹¹⁵ Since 1 January 2003, the debtor must further, within the seven-day period, furnish a copy of the notice *by post* to every registered trade union which, to the applicant's knowledge, represents any of the debtor's employees; and to the employees themselves. It is submitted that if the section is inapplicable in that the debtor is not an

¹¹² Le Roux op cit note 102 at 68 states that the purpose of s 187(g) appears to be to attempt to limit job losses, but, owing to its limiting effect on transfers of businesses as going concerns, it may actually 'destroy jobs rather than protecting them'.

¹¹³ See the Insolvency Second Amendment Act 69 of 2003 for amendments to the IA and the Companies Act 61 of 1973 in this regard.

¹¹⁴ Section 3 of the IA.

¹¹⁵ Section 4 of the IA.

employer, or where, to the applicant's knowledge, no trade union represents the employees, this should be indicated in the application. Section 9 of the IA (which applies to the compulsory sequestration of an insolvent debtor's estate upon application by a creditor) was also amended with effect from 1 January 2003. In particular, s 9(4A)(a)(i)–(iii) now requires that when an application for compulsory sequestration is to be presented to the court, the applicant must also furnish a copy of the application to every registered trade union which, as far as the applicant can *reasonably ascertain*, represents any of the debtor's employees, or must furnish a copy of it to the employees themselves.

As far as notice to a trade union is concerned, it is submitted that, where appropriate, the applicant should state in the founding affidavit that there is no trade union to which notice must be given, or the applicant should mention which trade union(s) he or she could reasonably ascertain might represent the employees. If the applicant has no employees, this should also be mentioned in the affidavit. The applicant must before *or during* the hearing provide proof of compliance with each provision of s 9(4A)(a) by means of an affidavit deposed by the person who furnished the copy of the application as required by the legislation.

The same notification procedures will also apply to an application for the winding up of a company or a close corporation.¹¹⁶ In this regard it is also of interest that, with effect from 1 August 2002, s 197B(1) of the LRA provides that an employer who is experiencing financial difficulties which may reasonably result in the winding-up or sequestration of the employer must advise a 'consulting party' of the employees contemplated in s 189(1) of such fact. Such consulting party includes any person to be consulted in terms of a collective agreement, a workplace forum, a registered or unregistered trade union or representative of the employees, depending on the circumstances. In terms of s 197B(2)(a) an employer who applies to be wound up or sequestrated, whether in terms of the IA or any other law, must, at the time of application, provide a consulting party contemplated in s 189(1) with a copy of the application. Likewise, an employer who receives an application for its winding-up or sequestration must supply a copy of the application to a consulting party contemplated in s 189(1). In such an instance it is incumbent upon the employer, in terms of s 197B(2)(b), to supply the prescribed copy of the application within two days of receipt, or, if the proceedings are to be brought urgently, within 12 hours. It is submitted that, having regard to the reference in s 197B(2)(a) to an employer who 'applies' to be wound up or sequestrated, the provision does not apply in relation to a creditors' voluntary liquidation of a company envisaged by s 351 of the Companies Act 61 of 1973, or of a close corporation pursuant to the provisions of s 67 of the Close Corporations Act 69 of 1984, since such winding-up process is not initiated by an application.

¹¹⁶ See the Insolvency Second Amendment Act 69 of 2003. In terms of s 66 of the Close Corporations Act 69 of 1984, read in conjunction with the amendments to the Companies Act, this will apply to the winding-up of a close corporation as well.

CONCLUSION

It is ironic that while the South African Law Reform Commission has since the 1980s been conducting an ongoing review of insolvency law, the little reform that has occurred has been mostly labour-driven. Apart from legislative amendments for which the labour movement provided the momentum, the courts have also shown willingness to recognize and to develop labour law principles in other areas, such as insolvency, where the different principles converge. The importance of labour-driven insolvency law reform is thus evident not only in legislative but also in judicial interventions.

The recent amendments accord with the constitutional and labour imperatives of the current political system. These amendments have fixed the spotlight on the general right of employees to fair labour practices within the insolvency framework. Employees have become an important group of creditors, and what is more, are now even recognized as an interest group on their own within the insolvency law framework. Trustees and liquidators should realize that it is no longer 'business as usual'. The position accorded employees has improved significantly: contracts of employment no longer terminate automatically upon sequestration or liquidation of the employer, but trustees and liquidators are required to follow procedures akin to those prescribed in the LRA prior to terminating any employee's contract of service; employees are entitled to severance pay irrespective of whether they were dismissed or their contracts terminated as a result of the sequestration or liquidation of their employer; employees' benefits have increased in respect not only of the maximum amounts of the claims which are permitted in each category, but also in relation to the position of their preferential claims in the ranking of claims against the insolvent estate; all employment contracts are transferred to a new employer (the purchaser) when an insolvent business is transferred as a going concern; and employees have the right to be notified of pending sequestration and liquidation proceedings. The latest round of legislative reforms has also focused attention on business rescue, currently a common trend in insolvency law reform, worldwide. While the introduction of business rescue into the IA in such a haphazard way, without a more holistic approach, is open to criticism, it is at least a step in the right direction.

However, employees and their trade unions, in our submission, ought to adopt a certain measure of realism regarding the extent to which the right to fair labour practices has the capacity to protect them. Economic realities create limitations where insolvent estates are concerned. In our view, such realism is already reflected in s 36(1) of the Constitution, which recognizes that the fundamental rights enshrined in the Constitution are not absolute, but that they may be limited to the extent that such limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom. Employees ought to realize that although the right to fair labour practices purports to afford them extensive protection, it may, regrettably, boil down to very little in the face of financial realities posed by an insolvent employer.